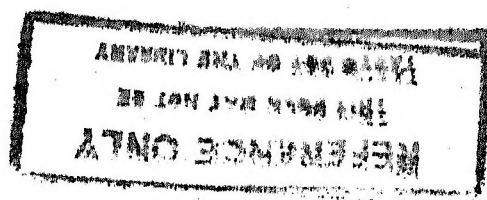


DEPARTMENT OF TRADE AND INDUSTRY

Professional Liability

Report of the Study Teams

Chairman
Professor Andrew Likierman



HER MAJESTY'S STATIONERY OFFICE



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Report of the Steering Group

Steering Group Report

Introduction

1.1 In May 1988 the Secretary of State for Trade and Industry announced the appointment of three fact-finding study teams:

“in the light of current concern about the cost and availability of professional indemnity insurance and the extent of professional civil liability for negligence”

to look into the problems of three selected professions—auditors, those involved in the construction industry and surveyors (other than those involved in construction). Membership of the study teams included users of the services, insurers, and legal experts as well as members of the professions. (The full terms of reference for the studies are included with the study teams' reports.)

1.2 A steering group was appointed at the same time, chaired by Professor Andrew Likierman of the London Business School, and with a membership of the Chairmen of the three study teams—Professor Donald Bishop, formerly of University College, London (construction industry), Mr William Morrison, Deputy Senior Partner, Peat Marwick McLintock (auditors) and Mr Ian Oddy, Professional Standards Partner of St Quintin (surveyors). Mr Richard Grafen of the Department of Trade and Industry acted as Secretary to the steering group.

1.3 The steering group co-ordinated the work of the three teams. This report summarises the results of the work and draws out more general conclusions in the light of wider public interest issues. A summary of the recommendations of the three teams is attached.

1.4 Important differences between the professions studied by the three teams have influenced the approach the teams have taken, as well as their findings and recommendations. The differences include:

a. Coverage: The auditing study team dealt with one part of the work undertaken by the accountancy profession; the surveyors with the work of a single profession—albeit with many different aspects to the work. The construction team dealt with the work of several professions, and their report is thus correspondingly longer than the others.

b. Statutory basis: While the principal categories of audit work are statutory, the work of the other professions is not.

c. Client base: Auditors and the construction professions work largely for companies or public authorities: surveyors work as often for private individuals as for corporate or public bodies.

d. Terms of appointment: Auditors have to be appointed each year; the services of the construction professions and surveyors are most often provided on an ad hoc basis to clients.

e. Degree of collaboration: It generally requires several construction professions to collaborate in their project work (each dependent on the other) and their work is brought to fruition by contractors. Auditors and surveyors tend to work more on their own.

f. Nature of work: The auditors' and surveyors' work is relatively discrete while that of the construction industry is often an integral part of a production process.

1.5 Each team has, however, been conscious of the need to bear in mind the relative position of professionals and consumers: in particular the private individual who only occasionally makes use of professional services may well have neither the experience nor the resources to pursue a claim. The teams have also been very aware that clients and professionals will benefit if the professional is motivated by a desire to provide a good and efficient service at a competitive price, rather than by a wish to gain protection against the possibility of a negligence claim.

1.6 The study's terms of reference have been interpreted as applying to professionals in practice as sole traders, partnerships or companies. There are also understandable concerns about professional liability matters among employed professionals, particularly in the public sector. However these groups, because of the differences in their legal position and in their particular needs for insurance

arrangements, have not been covered in the study.

The background

2.1 Many professions have expressed fears about what they perceive to be the current trend of professional liability, and not only those covered by the three studies. For example, the Government has recently proposed that health authorities should indemnify NHS hospital doctors against negligence claims because of the enormous increases in the costs of medical defence subscriptions and concerns that recruitment into high risk specialisms could suffer. In other countries, professions have declared similar concerns and the European Commission is currently sponsoring a study into the possibility of harmonising liabilities, guarantees and insurance in the construction industry.

2.2 These fears about liability have been fuelled by an increase in litigation against professionals in the United Kingdom and instances of gross discrepancies between awards and fees—a £100 assignment, as an extreme example, resulting in a £400,000 claim. More directly, the rise in insurance premiums and reported difficulties in finding insurance cover in recent years have created the possibility that professionals might have to withdraw from providing certain services altogether.

2.3 There is a danger that the atmosphere of distrust engendered by increased litigation could change dramatically, and for the worse, the traditional relationship between professional and client. The financial exposure to such developments of individual partners in professional partnerships, even after they have retired, has understandably been of particular concern.

2.4 Until now, however, much of the evidence about trends has been anecdotal and the need for fact-finding studies has been all too clear. The evidence which has been gathered by the three study teams has been based on the views of all relevant parties and includes the results of major questionnaire surveys. Despite the inevitable constraints on the samples taken—particularly the difficulties in obtaining representative views of the users of services—the steering group are confident that the information provides a sound basis for the findings and recommendations and indicates the existence of a wider problem.

The findings

3.1 The evidence from the three study teams has shown that there has been a significant

change since the 1970s in the exposure of professionals to negligence claims. This change has not been related to any discernible increase in negligence. Indeed there is a great deal of evidence of improved professional standards. Rather the change has come about through the development of the law (by decisions of the courts rather than legislation), and through a greater readiness to litigate on the part of those who have suffered loss. The sums involved have been increasing in real terms. The costs of becoming involved in litigation have also escalated for both plaintiffs and defendants.

3.2 Coinciding with these developments, there have been rapid movements in the cost and availability of professional indemnity insurance (PII). Costs have not displayed, as many have supposed, an inexorable upward trend. Rather cost and availability follow the cyclical pattern of the insurance market generally as insurers and reinsurers enter and leave the market. This cycle was particularly marked for PII in the mid-1980s when typical premiums increased threefold, the accompanying terms became more onerous and coverage thought desirable for very large losses was no longer available. During this period many professionals carried, and continue to carry, more of the risks themselves and some began to develop mutual funding schemes.

3.3 The evidence, taking the three studies together, showed differences linked to size of both clients and professionals. The differences in the problems faced by clients of different sizes are understandable when considering that they range from very large companies and public bodies to individuals with little experience of employing professionals. The former are usually highly sophisticated in their dealings with professional firms. The latter are often unclear what to expect from professionals, and problems can arise from different perceptions about the service being provided.

3.4 The study teams also identified some evidence of a difference between small practitioners and the large firms of professionals. The smaller practices were (and still are) often most concerned about fluctuations in the cost of insurance premiums, whereas some of the larger ones, particularly the large firms of auditors, have generally been more concerned with the terms and availability of cover. While the cost in management time and effort in defending claims is of increasing concern to all professionals, it is medium-sized and small practices which are less able to absorb this diversion of effort.

3.5 In the last year or so, however, the insurance market has become generally easier, with some premiums decreasing and improvements in what the premiums will buy. This amelioration does not mark the end of the problem, nor has it been across the board; large firms of auditors still cannot obtain all the insurance cover they need and the reduction in their maximum coverage appears to be a long-term change. More important, bearing in mind the cyclical nature of the insurance market, the problems will undoubtedly resurface when the insurance market hardens again.

3.6 Regardless of the fluctuations in the cycle, the effect of the changing climate of litigation has been to change the balance between professional and client and to affect the services which professionals are willing to provide in two particularly important ways. First, the increased costs to the professionals of PII and of defending claims have either been passed on to the client or, where this has not been possible, have been borne by the profession. Second, professionals are becoming more cautious: this manifests itself in a variety of ways, including writing reports with more qualifications, seeking to shift risks to clients or to subcontractors, and being less willing to take on work which they perceive involves high risks of negligence claims.

3.7 The evidence shows that these effects are limited but increasing. The individual study teams have not, however, found evidence of services becoming widely unavailable, though if the size and number of claims, settlements and awards continue to grow, there can be little doubt that the pressure to withdraw from certain high-risk areas will increase with the next cyclical hardening of the insurance market.

3.8 The study teams were asked to comment on developments in relation to the European Community. While the professions will be affected in different ways by the single European market it is still too early to judge the impact of the European dimension on the liability problem. For example the work undertaken by M Mathurin on behalf of the Commission may well have significant implications for the construction industry, on the time limitation of liability for construction contracts and on the requirements for mandatory insurance. It is not clear, however, whether such proposals would be acceptable to Community member states, nor whether they would have wider implications. As in other potentially sensitive areas,

matters will need to be monitored most carefully at a government level and intervention, if deemed desirable, will need to be at an early stage in the discussions. Whatever happens to the Mathurin proposals, the interest in professional liability in many countries—not only those in the European Community but also throughout the world—will mean that there will be significant international pressures on the development of practice in the United Kingdom.

Conclusions

4.1 In drawing up their conclusions, the steering group have been made aware from the reports of the individual study teams that the same external influences are affecting each profession. However, the differences in the effects of these influences mean that a different package of proposals is appropriate for each profession. The packages are necessary to address the two main problems which have been identified:

- a. a shift in the balance of interests between professions and their customers, resulting in a widespread belief among professionals that, in terms of professional liability, they are now operating at a significant disadvantage.
- b. the likelihood that when the PII market hardens, there could be a serious reduction in the availability of the services provided to consumers, in the value to the client of the terms that the professional is prepared to offer and in the circumstances in which the professional is prepared to operate.

Limiting the professionals' liability

4.2 **Capping** means that for each distinct piece of work there is a maximum limit beyond which the professional would not normally be liable for any consequences. Statutory capping is one of the most common proposals put forward by professionals but none of the study teams believe that it is appropriate at this stage. There are also significant practical problems in devising a system which would operate fairly. For example no single monetary figure would be appropriate for all circumstances, and while linking maximum potential liability to the fee paid might be less unreasonable, within each profession there are wide variations in the ratio between the fee paid and the damage which can be caused by negligence.

4.3 **Forming companies with limited liability.** Although the option of limiting liability by turning professional partnerships into limited liability companies is already available to many professionals, and has been adopted by some, it

is not a general remedy for problems relating to professional liability. In the event of a settlement or award exceeding its insurance cover and net assets, a company will become insolvent, and, even though personal assets may no longer be at risk, corporate insolvency is not a better remedy or any more tempting than personal bankruptcy. If, however, the balance continues to shift against the professional and no other action is taken, the marginal benefits of incorporation may well lead more professionals to become companies.

4.4 Placing contractual limits on individual pieces of work is an option already available to most professionals, though the effectiveness of such disclaimers can be doubtful because of the uncertainty of whether the terms might fall under the Unfair Contract Terms Act 1977. This excludes unreasonable restrictions on liability for economic loss. Recent House of Lords decisions (*Smith v Bush* and *Harris v Wyre Forest District Council*) have provided some clarification of what 'reasonable' means in this context. The Lords held that certain disclaimers, in the terms of appointment of valuers carrying out mortgage valuations, were unreasonable. A valuer making such a report will now in effect be unable to exclude his liability to his clients or to known third parties. The decisions were linked to low value property, however, and it remains unclear whether a disclaimer might be valid in connection with high value residential or commercial property.

4.5 The surveyors study team recommends that professional bodies should be able to submit standard disclaimers for official approval. Auditors and their client companies are prevented by statute from agreeing such limits, and the study team recommends that this should be changed.

4.6 Time limitation. The time gap between a negligent act and a claim arising from it means that professionals have to maintain insurance cover for past actions even after they have ceased to practise. The burden which this puts on professionals has been addressed by legislation which seeks to establish time limits for bringing actions. This legislation is, however, complex and unclear and it is still possible in special circumstances for a professional (or their widow or widower) to be sued well beyond 15 years after a breach of duty. Of the professions being studied, limitation presents the most severe problems for construction professionals because, unlike most other professionals, their work routinely leads to long-lived physical end-products. The construction

team's report therefore recommends that the system should be simplified and an unambiguous backstop should be provided ten years after work is completed.

Spreading the risk

4.7 Amending the law on joint and several liability. An individual professional often runs the risk that while not being solely responsible for damage, he or she is more often insured than the other parties. Those who wish to sue therefore will often pursue the professional first because other parties may have no resources or may have gone out of business. In these circumstances the general law of joint and several liability often dictates that the professional will have to meet the claim in full. The fact that plaintiffs pursue the professionals as the 'deep pocket' is in turn one of the reasons why professionals need to take out substantial insurance policies. Many professionals therefore argue that in commercial matters they should be liable only for the share of the damages which would be apportioned to them as just and equitable—a principle already embodied in the Civil Liability (Contribution) Act 1978—if the other defendants were able to pay their shares. Such legislation has been enacted in several states in the United States.

4.8 It is clear that a change in the general law of joint and several liability to meet this problem would have major implications outside the field of professional liability. The matter should therefore be referred to the Law Commission who would be better placed than a study group with limited terms of reference to assess both the wider implications and the detailed effects of any change. (The Law Commission would no doubt wish to consider the possible impact on professions other than the ones which have been covered.)

4.9 Spreading the insured risk. Another approach to spreading the risk is to seek to make it more likely that other potential defendants will be in a position to meet their share of each claim. The construction industry professionals face particularly difficult problems in this field. They may well be prime targets for litigation where they are known to have PII, to be involved in the project from start to finish and to have a continued existence which contrasts with other parties protected by limited liability who may have sought liquidation. The construction industry team recommends that clients should themselves insure against categories of the most costly latent defects. The surveyors team recommends that there should be compulsory PII for all those involved in

providing services. In these circumstances each defendant found liable would have to pay only the share corresponding to the relevant share of their responsibility.

4.10 The most common potential co-defendants of auditors are the directors of the company under audit, and although there has recently been a substantial increase in the number of large companies whose directors are insured—in recognition of the risks they face—many directors are still uninsured. This may partly be because there remains some doubt in law about the way in which a company is allowed to insure its directors, and the auditors team recommend that this should be clarified, while stopping short of recommending compulsory insurance for directors.

Reducing the risks of negligence

4.11 Each of the study teams concluded that the relevant professional bodies have a responsibility to seek to minimise negligent professional work by their members. Larger organisations generally understand what is required in dealing with professionals, but as already noted, vulnerable clients are often those individuals and small businesses with very little experience of employing professionals. Such clients may have little understanding of the range of services available or their limitations. The surveyors and construction industry study teams saw improved quality management and clearly drafted conditions of engagement as among the most direct (and productive) ways of improving understanding and resolving problems of professional liability.

4.12 The same two teams recommended that the appropriate professional bodies should review their policies in areas such as the guidance to members on quality management, risk management, continuing professional development and guidance to clients on managing projects. The construction team report goes further and includes advice to individual professionals and their clients. On the other hand the auditors team observed that the accountancy bodies are active in issuing and updating standards and guidelines, and that their role was likely to be enhanced by the present Companies Bill. They therefore saw no need to recommend action in addition to that already in hand.

Reducing the costs of litigation

4.13 As with all commercial litigation, the costs of defending claims in court, not only for legal advice, but also in professionals' own time, are potentially enormous. Even if the defence is successful, the defendant will recover

only a part of these costs from the plaintiff and none if the plaintiff has no money or is legally aided. Great concern was expressed by some professionals about the way in which claims by those receiving legal aid are often settled without proper challenge and very quickly. It seems anomalous that legal aid will support a plaintiff in making a claim but will not contribute to a defendant's costs if the claim fails. This is true for all defendants and not just professionals, and so there appears to be a case for wider consideration of this anomaly which goes beyond our terms of reference.

4.14 Each of the study teams considered whether action could be taken to simplify the procedures for smaller professional negligence claims. The surveyors and construction industry teams both saw scope for short-procedure arbitration schemes.

4.15 Another suggestion occasionally made is that there should be a system of strict liability (also known as 'no fault' liability) compensation. Compensation of this kind would enable those who have suffered injury not to have to prove negligence, nor to rely on adequate resources or insurance being available. This suggestion was found to be impractical in the context of the professions being studied, where the damage is generally economic, often on the part of a client who has entered into a transaction hoping to make a profit. Whereas it may be right that such a client should be able to recover damages if the cause was negligent professional advice, it would make no sense to seek to compensate the disappointed speculative investor. Insurance would certainly not cover such risks.

The future

5.1 Even while the work of the study teams was being completed, there were major developments in the field of professional liability. Key cases have been decided including *D & F Estates*, *Smith v Bush* and *Harris v Wyre Forest District Council*. Other key cases are pending, notably the Caparo case with its importance for auditors.

5.2 Meanwhile the insurance market has softened and the immediate problems of the mid-1980s have eased. Yet an increase in costs of PII, probably in the early 1990s, can be confidently predicted and there is no reason to think that the increase will be any less sharp than the previous rise.

5.3 Generally, the approach of the three study teams has been to commend a package of

measures specific to the professions covered by each. These recommend action to be taken by the respective professions, by their clients and by insurers as well as by the government. If implemented, they will significantly improve the chances of avoiding the adverse effects of the next hardening of the insurance market on the services offered by these professions. There will thus be wider benefits to the economy as a whole.

5.4 As for the implications of these findings for other professions, it is clear that at least some of them will have been affected by the trends in insurance and law which have affected the professions covered by the study teams. A review by government to establish what specific problems these may cause and whether any measures would be appropriate on a profession-by-profession basis is required urgently before problems inevitably arise from the consequences of the forecast increase in premiums and reduction in availability of insurance in the early years of the next decade.

28 April 1989

Summary of Recommendations of the Auditors Study Team

The study team found that auditors are facing an increasing number of claims involving larger amounts of money. The sheer scale of the potential exposure is striking, and auditors are prevented from negotiating limits to their liability. Insurance is not available at the levels the larger firms require. The costs and risks increase costs of audits for clients and are likely to have adverse effects on the service provided.

The study team has considered and rejected a number of proposed changes, including capping the liability of the auditor in relation to each audit.

The study team recommends the following:

1. The Law Commission should be asked to examine the possibility of change in the law of joint and several liability.
2. The use of directors and officers insurance should be encouraged and the Government should facilitate this by clarification of the Companies Act 1985, and by allowing premium payments as a cost for taxation

purposes. Apart from the direct benefit to directors, this would mean that in circumstances where there are a number of potential co-defendants, the auditor would less often be the only person with the resources to meet the claim.

3. The Law Reform (Contributory Negligence) Act 1945 should be amended so as to make clear that negligence by a plaintiff is relevant to awards in cases involving breach of contract as well as in tort or delict.

4. The Companies Act 1985 should be amended so as to allow each company and its auditor to agree a reasonable limit of liability, which is currently prevented by section 310 of that Act. This would put the audit contract on the same footing as other contracts.

Summary of Recommendations of the Construction Professions Study Team

The objectives of improved quality and risk management, clarity of responsibilities and greater certainty in law can be pursued immediately through initiatives by the institutions and associations representing clients, the professions, consultants and insurers. The recommendations invite them to, *inter alia*:

- establish a trans-professional short arbitration procedure which would mainly serve the interests of occasional clients and domestic clients;
- devise reformed and unified consultants' conditions of engagement;
- review the arrangements for regulating the standards of professional competence of members;
- play a more active role in providing quality and risk management advice.

In the medium term and beyond, it is unlikely that all of the problems highlighted can be resolved without legislation.

Time limitation

It is recommended that serious consideration be given to alterations in the law to make time limitations of liability certain. This proposal is supported by all the institutions and associations and by the British Property Federation.

The proposal is (with complementary amendments to Scottish law) to amend the Limitation Act 1980 (and thus the provisions introduced

into the 1980 Act by the Latent Damage Act 1986) to achieve the following:

- a limitation period for negligent actions in tort and in contract (whether or not under seal) of 10 years from the date of practical completion or effective occupation (staged if necessary);
- the 10 years limitation period acting as a longstop extinguishing the right;
- substituting for the term 'deliberate concealment' some other term such as 'fraudulent concealment'.

These statutory provisions, although part of general law, are crucial to construction litigation because of the importance of latent defects. The principle of a decennial limitation period is already part of English statute law.

Joint liability

The study team recommends that serious consideration be given to the alteration of the law in commercial cases not involving personal injury. In such cases a defendant whose actions are partly the cause of damage to the plaintiff, but such actions were not carried out jointly with another defendant, should be responsible to the plaintiff only for damages equivalent to that part of the plaintiff's loss fairly attributable to his breach.

This recommendation is strongly supported by the professional institutions and consultants' associations. The British Property Federation accepts that the current law can be unfair to consultants. Clearly this recommendation, of crucial importance to the construction professions, raises issues of public policy.

Summary of Recommendations of the Other Surveyors Study Team

There are a number of important changes which should be considered further from the viewpoints of both the professional and the client ie the individual consumer, and in the public interest.

1. *Public understanding of the services provided*: all those concerned with offering surveying and associated services to the public should actively consider how best to improve staff training and ensure better communication with and guidance for the public.
2. *Professional standards*: all professional bodies covered by the terms of the Study

Team's remit should adopt relevant schemes for career-long continuing education for all their members.

3. *General standards of competence*: competence standards should be introduced, including regulations under section 22 of the Estate Agents Act 1979.

4. *Other suppliers of services eg contractors*: statutory standards of competence should apply to all suppliers of services linked to surveying services.

5. *Compulsory PII*: compulsory PII should be made a statutory obligation for surveyors and for the providers of all other services connected with surveying.

6. *Strict liability ie 'no fault' liability insurance*: this course of action, which would require a Government financed scheme, should not be pursued.

7. *Capping ie limiting liability*: this course of action should not be pursued.

8. *Lending bodies Ombudsman*: the proposal to extend the Building Societies Ombudsman Scheme to cover negligence claims and the awarding of costs in mortgage valuation and survey cases involving all lending bodies, should be investigated further. The Ombudsman's decision would be binding on all parties, subject to an appeal to the courts on a point of law only.

9. *Statutory arbitration scheme*: the RICS arbitration scheme should be given statutory backing to deal with non-lender disputes.

10. *Model clause 'certification'*: the proposal that standard exclusion or limitation of liability clauses be submitted by professional bodies and approved by a statutory body, should be investigated further.

11. *Loan certificates*: this idea should not be pursued.

12. *Entitlements to compensation*: for cases up to a ceiling of say £10,000 index-linked in line with inflation, the costs of rectifying negligence should be awarded on the basis of making good the damage and providing recompense for eg distress, moving costs etc, with some adjustment for betterment.

Professionals in the public sector

All the professional liability issues facing surveyors and other professionals in the public sector should be the subject of a special study.

Matters for wider consideration

Two matters of concern were identified in the course of the Study which had a major impact on surveyors, but which could only be considered in a wider context. They are important candidates for further study:

- (a) *Legal aid system*: At the very least, a successful non-legally aided defendant should be entitled to recover his costs against the legal aid fund—as a matter of course, in the same way as he would be entitled to recover his costs against a non-legally aided plaintiff.
- (b) *Joint and several liability*: the Study Team would support any move to limit liability to that portion of damages for which a negligent professional was found liable. Such a step would not be regarded as inequitable if all the recommendations proposed were implemented, particularly the statutory requirement for the performers of all services to take out indemnity insurance.

Report of the Auditors Study Team

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PART 1

Introduction

1.1 We are one of three study teams whose appointment was announced by the Secretary of State for Trade and Industry, Lord Young, on 11 May 1988 to carry out fact-finding studies into the liability problems of selected professions. The terms of reference are at Annex 1. They define the scope of this team's study as: 'auditors (and other accountants in independent public accounting practice who carry out reporting functions arising out of statutory requirements)'.

1.2 Although we have concentrated on accountants as auditors, inevitably much of the evidence applies to accountants generally; and some, particularly in relation to law and insurance, applies to professionals in general and to others.

1.3 The membership of our team is given in Annex 2.

1.4 The Department of Trade and Industry's press notice of 11 May 1988 invited anyone wishing to give evidence to write to the secretary of the study team.

1.5 We invited and received written contributions from and held meetings with the professional bodies representing auditors:

- The Institute of Chartered Accountants in England and Wales
- The Institute of Chartered Accountants of Scotland
- The Institute of Chartered Accountants in Ireland

(The three Institutes of Chartered Accountants (ICAs) formed a single working group to co-ordinate their contribution)

- The Chartered Association of Certified Accountants (ACCA)
- The Association of Authorised Public Accountants (AAPA)

1.6 We received written contributions from and held meetings with insurance brokers dealing with professional indemnity insurance

(PII) for accountancy firms of all sizes, both through schemes or facilities arranged at the instance of professional bodies or through the open market (listed in Annex 3). We also held a meeting with the Sun Alliance Insurance Group, a principal PII underwriter for small and medium-sized accountancy practices operating in the United Kingdom.

1.7 In order to obtain views of users of auditors' services, both as clients and as other readers of accounts, questionnaires were sent to the members of the Hundred Group of Finance Directors. Of the 134 members, 67 responded and the results are summarised in Annex 4. We also invited comments from the Confederation of British Industry, the Institute of Directors, and the Securities and Investments Board.

1.8 We carried out a survey of auditors in the United Kingdom, the methodology and results of which are set out in Annex 5. We excluded the 20 largest accountancy firms from the survey and wrote to them separately inviting contributions. Sixteen of the 20 submitted written evidence, generally supporting the ICAs' submission and supplementing it from their own experience. We held meetings with two of these firms.

1.9 We received legal papers from and met with two firms of solicitors:

Herbert Smith, instructed by the ICAs; and Barlow Lyde & Gilbert, who have been actively involved in many of the recent major claims affecting accountants.

Mr Hugh Evans, barrister, assisted us in the preparation of Part 3 of this report.

1.10 We also had meetings with Mr Patrick Phillips QC and Mr Emile Woolf FCA, FCCA.

Description of the Audit Service

The accounting profession

2.1 The accountants with whom this study is concerned are those qualified to perform statutory audits. These are defined in relation to Great Britain in section 389 of the Companies Act 1985 and fall into two categories:

- (a) Members of one of four professional bodies—the three ICAs and ACCA. Under the rules of these bodies members must hold a practising certificate in order to be able to carry out the audit function.
- (b) People individually authorised by the Secretary of State for Trade and Industry. It is from this category of accountants that AAPA draws its membership.

2.2 The equivalent of the Companies Act 1985 in Northern Ireland is the Companies (Northern Ireland) Order 1986. There are only minor differences between the two pieces of legislation, for example Article 397 of the Order defines those qualified to audit as above, except that it is the Department of Economic Development which may authorise individuals. The differences are not significant for the purposes of this report. The Companies Bill referred to below is expected to be followed by similar legislation for Northern Ireland.

2.3 The Companies Bill currently before Parliament would replace section 389 with a system whereby a person would be eligible to be a company auditor only if he was a member of a recognised supervisory body and was eligible under that body's rules. A condition of membership would be the holding of an appropriate qualification which would in turn be granted by a recognised qualifying body. The Secretary of State would have power to recognise these bodies, and it is not yet known who they will be. It is, however, expected that the three ICAs and ACCA will apply to be both supervisory and qualifying bodies.

2.4 Since the beginning of 1984, ACCA has required professional indemnity insurance (PII)

as a condition for holding a practising certificate. Members of the ICAs who are authorised to carry on investment business have had to have PII since the beginning of 1989; and PII will become a compulsory requirement for practising certificates for members of the ICAs from the beginning of 1990.

2.5 Section 389 of the Companies Act 1985 prevents incorporated bodies from acting as auditors, so that auditors must practise either as individuals or as partnerships in which every partner is permitted to audit. The current Bill would allow auditors to practise as companies, with limited or unlimited liability, as an alternative to partnerships. It would also allow audit practices to have shareholders, directors or partners (as appropriate) who were not qualified to audit, provided that control rested with persons authorised to carry out audits.

2.6 In the United Kingdom, there are around 14,000 sole practitioners and around 5,000 partnerships entitled to carry out audits. The partnerships vary in size from two-partner firms with no professional staff up to the largest which currently has around 500 partners, 7,000 professional staff and an annual fee income exceeding £275 million. There are eight very large partnerships ('the Big 8'), seven which have over 200 partners and all of which have an annual fee income greater than £100 million; and a further 12 firms each of which has between 70 and 250 partners and an annual fee income of between £20 million and £75 million. In total there are over 70 firms with annual fee incomes greater than £1 million. We believe that the Big 8 receive about 35 per cent by value of the annual aggregate audit fees paid to UK accountancy firms and the top 20 firms about 50 per cent thereof.

2.7 Most of the 70 firms are involved in some overseas work, if only through involvement with the foreign subsidiaries of UK clients. Of the largest 20 firms, most have formal links with international groupings of accountants, so as to be able to provide comprehensive accounting

services to multi-national companies. The eight groupings to which the eight largest UK accounting firms belong are also the largest accountancy groupings worldwide. The UK practices of the Big 8 account for some 10 per cent of the turnover of their international groupings, as is shown by the broad comparison in Annex 6 shows.

2.8 Apart from auditing, accountants provide general accounting services and advice to businesses and individuals. Many also act as management consultants, give advice on tax, conduct investment business and act as insolvency practitioners. A number of firms provide advice on mergers and acquisitions. Our survey of auditors (Annex 5) suggests that income derived from auditing represents on average 32 per cent of total fee income for sole practitioners and 37 per cent for partnerships. We believe that the share of income from audit work is on average slightly higher for the largest partnerships.

The audit service

2.9 Every registered company is required by the Companies Act 1985 to draw up annual accounts, have them audited and circulate them to shareholders. Limited companies (the vast majority) must also file a copy at Companies House (formerly Companies Registration Office). The auditor's statutory rôle is set out in sections 236 and 237 of the Act (Annex 7). In summary, they have to carry out the work they deem necessary to enable them to sign a report saying whether the accounts have been properly prepared in accordance with the Act, and whether in their opinion the accounts give a true and fair view of the financial position of the company. (For companies which take advantage of the special rules for banking or insurance companies, the auditors do not have to give an opinion on whether the accounts give a true and fair view, but rather on whether they comply with these rules.)

2.10 While it is for the company's management to draw up the accounts, and for the auditor to audit them, and this is the practice in large companies with internal accountancy expertise, in smaller companies the auditors often participate to some extent in drawing up the accounts, or even in writing up the books before the accounts are drawn up.

2.11 The basic legal requirements are supplemented by the professional bodies which approve guidance prepared by committees of the Consultative Committee of Accountancy Bodies (CCAB—comprising the ICAs, ACCA,

the Chartered Institute of Management Accountants and the Chartered Institute of Public Finance and Accountancy). The Accounting Standards Committee of the CCAB proposes accounting standards (designated Statements of Standard Accounting Practice) and Statements of Recommended Practice which respectively prescribe and recommend certain basic principles upon which accounts are to be prepared. The Auditing Practices Committee proposes Auditing Standards and Auditing Guidelines which respectively prescribe and recommend guidance on the detailed application of auditing procedures and techniques.

2.12 The contract between the auditor and his client company can set out the terms on which the auditor is appointed, and can extend the work of the auditor beyond the requirement of the statutory audit, but it cannot reduce in any way the auditor's statutory duties, nor can the company use it to indemnify the auditor against any liability (because of section 310 of the Companies Act 1985, explained in paragraph 3.3 below).

Other legislation

2.13 Most audits are of companies registered under the Companies Act 1985, but accountants provide similar audit services to other bodies under a variety of legislation. The most important are audits of building societies under the Building Societies Act 1986, and of financial services businesses which are not companies (eg partnerships) under the Financial Services Act 1986. There are further statutory reporting duties in relation to listing requirements and prospectuses for unlisted securities under Parts 4 and 5 of the Financial Services Act 1986. (Both of these 1986 Acts apply to all parts of the United Kingdom.)

Current developments

2.14 Under the Companies Bill, the professional bodies are intended to have a more active monitoring and enforcement rôle in relation to auditing than they exercise at present. (Accountants who conduct investment business are already subject to regulation by their professional bodies under the Financial Services Act 1986.)

2.15 Open competition between accountants to provide audit services has increased in recent years, accelerated by the fact that members of the ICAs and ACCA have been allowed to advertise since 1984. Companies considering changing their auditor increasingly seek tenders from a number of firms of accountants before

deciding to appoint a new auditor or to reappoint the existing one.

2.16 A number of recommendations on the process for setting accounting standards were made in late 1988 by the Accounting Standards Review Committee, appointed by the CCAB and chaired by Sir Ronald Dearing. The most relevant to our study related to the support which the Review Committee considered should be given by the courts to accounting standards, but the Government have recently announced that they do not intend to implement this recommendation.

PART 3

The Law on Auditors' Liability

3.1 Our terms of reference require us to 'Obtain information about how the law has operated in the past and how it currently operates in relation to actions in negligence against' auditors. As will be seen below, we have concerned ourselves primarily with the current position and its uncertainties. Except where specifically stated, this Part relates to the law in all parts of the United Kingdom.

3.2 Auditing is not a separate profession, but part and parcel of the services provided by accountants, and much of the relevant law relates to a wider sphere than audit. Because auditors' liabilities result from breaches of contract as well as negligence in tort, we cover below both forms of liabilities.

3.3 Auditors rightly claim that they are in a position that is different from and more vulnerable than that of most professions because of the provisions of section 310 of the Companies Act 1985 (and Article 318 of the Companies (Northern Ireland) Order 1986), the text of subsection (1) of which is set out below:

"This section applies to any provision, whether contained in a company's articles or in any contract with the company or otherwise, for exempting any officer of the company or any person (whether an officer or not) employed by the company as auditor from, or indemnifying him against, any liability which by virtue of any rule of law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company."

The section goes on to provide that any such provision would be void, with the main exceptions

- (a) that a company is entitled to indemnify an auditor against liability incurred in defending civil or criminal proceedings in which judgment is given in his favour or in which he is acquitted, and

- (b) that any provision incorporating section 727 of the Companies Act 1985 would not be void.

Section 727 empowers the court to grant relief from liability to an auditor if he has acted honestly and reasonably and 'having regard to all the circumstances (including those connected with his appointment) he ought fairly to be excused for the negligence, default, breach of duty or breach of trust' involved. It seems to be generally agreed that it would be extremely rare for an auditor to be able to take advantage of section 727.

3.4 The importance of section 310 is that it prevents auditors limiting their liability by contract, at least to the company and its shareholders. It is not clear whether section 310 would prevent an auditor, in his audit report, disclaiming responsibility to third parties (and audit reports at present make no attempt to do so) or whether, if section 310 did not prevent them, such disclaimers would otherwise be effective. An accountant providing services other than those of a statutory auditor can do his best to negotiate with his client a limit on his liability and, where the result of his work may have a wider circulation, may try to limit his liability to third parties. Any attempt to limit such liabilities would be subject to the Unfair Contract Terms Act 1977 which enables the court to strike down unreasonable restrictions on liability for economic loss.

3.5 Some important principles have been established recently in the House of Lords cases *Smith v Bush* and *Harris v Wyre Forest District Council* which were heard together, judgment being given on 20 April 1989. Each of these cases concerned a reliance by a mortgagor on a negligent valuation of a property carried out by or on behalf of a mortgagee (in one a building society, in the other a local authority) which was under a statutory obligation to satisfy itself by a valuation that the loan could properly be made. In each case it would have been unusual in the circumstances for the mortgagor, who had already contributed to the mortgagee's

valuation, to pay for a separate structural survey or valuation. And in each case there was an express disclaimer of responsibility to the mortgagor. In one of the cases, the valuation had not been seen by the mortgagor.

3.6 The House of Lords held (a) in the absence of a disclaimer the valuer had a duty of care to the mortgagor, (b) the disclaimer amounted to a notice falling within the terms of the 1977 Act, and (c) in the circumstances the disclaimer was unreasonable and accordingly ineffective. The Lords did not consider that the duty of care to the mortgagor would inevitably arise whenever a valuation was made for a mortgagee. In the case of a more expensive property, the mortgagor, depending on the circumstances, could reasonably be expected to obtain a separate valuation or structural survey; and, if as a result there were no duty of care to the mortgagor on the part of the mortgagee or his valuer, the 1977 Act would be irrelevant.

3.7 It is not clear how this principle would apply to auditors if they were not prevented by section 310 of the Companies Act 1985 from limiting their liability. In some circumstances, third parties might reasonably arrange a separate accountant's investigation, for example if making a significant investment in a private company; but in other circumstances, for example when trading in shares on a stock market, the investor will not in practice have an alternative to relying on the published audited accounts. On the general question of liability Lord Templeman said in the recent case:

"It is open to Parliament to provide that members of all professions or members of one profession providing services in the normal course of the exercise of their profession for reward shall be entitled to exclude or limit their liability for failure to exercise reasonable skill and care. In the absence of any such provision valuers are not, in my opinion, entitled to rely on a general exclusion of the common law duty of care owed to purchasers of houses by valuers to exercise reasonable skill and care in valuing houses for mortgage purposes."

3.8 Apart from the effect of section 310, the main areas of concern to auditors (many of which they share with other professions) are:

- (a) Uncertainty as to the extent of their basic duty of care.
- (b) Uncertainty as to the persons to whom the duty is owed, ie who is entitled to claim against them if things go wrong?

- (c) The extra liability in which they may be involved as a result of their joint and several liability in claims in tort where they may be only one of a number of potential defendants.
- (d) Uncertainty as to the law of contributory negligence in contract.
- (e) An area which is still relatively unexplored—the extra dangers involved in the 'whistle-blowing' provisions of recent statutes and in the additional audit requirements under, specifically, the Financial Services Act 1986.

The basic duty of care

3.9 While an auditor is appointed by and reports to the shareholders, his contract is with the company. The terms of the contract are as much implied as express. The express terms are those provisions of the Companies Act which set out his duties, together with any additional items which he may agree with the management of the company. The implied terms are those which will be implied by the court, variously expressed as a need to exercise reasonable skill and care—to exercise at least a fair and average standard of industry and care—to act as a reasonably competent and cautious auditor—and many other similar expressions. It is claimed that no auditor who sets out on an audit can be certain how, if asked, the court would interpret the implied terms in relation to that particular audit. In practice such an interpretation, if it becomes necessary, will be determined with hindsight by the court, which will hear evidence as to the standards which other accountants would have expected themselves to have applied to the particular circumstances at the particular time. A measure of certainty, compared with other professions, is provided by the accounting and auditing standards and guidance issued by the CCAB (see paragraph 2.11 above). There is authority that these standards are very strong evidence as to the proper standard which should be adopted by accountants and, unless there is some justification, a departure will be a breach of duty (see *Lloyd Cheyham v Littlejohn* [1987] BCLC 303,313).

3.10 One thing at least is clear. Not every error or omission will be regarded as giving rise to a sustainable claim. The auditor is not the insurer or guarantor of the accuracy of the accounts audited by him, and the auditor who has taken all reasonable steps and exercised all reasonable care should not incur liability for the consequences of any inaccuracy. Even if the basic duty of care can be defined, there remain

the uncertainties as to the steps which the court would regard as being a reasonable minimum in order to fulfil that duty: an auditor will go a long way towards vindicating himself if he shows that he has thoughtfully (rather than slavishly) followed the recommendations of the accountancy profession, but the court may still take the view that this was not good enough in the particular circumstances. It has, further, been represented to us that the court tends to lean in favour of the plaintiff in cases involving claims against auditors.

3.11 If the inaccuracy of a set of accounts is linked to a well disguised fraudulent scheme, then it seems particularly likely that normal audit procedures may fail to detect it. The extent to which an auditor would be responsible for failure to detect fraud is uncertain, both because the law can give little guidance as to the precise circumstances in which an auditor should be able to discover a fraud, and because the law is unclear. It would seem that the auditor does not have to be suspicious, but if he encounters anything calculated to excite suspicion, he should probe it to the bottom (see *Kingston Cotton Mill Co (No 2)* [1896] 2 Ch 279). The Auditing Practices Committee of the CCAB has published an exposure draft of an Auditing Guideline entitled 'The auditor's responsibility for detecting and reporting fraud and other illegal acts' which, if adopted as a standard and subsequently considered reasonable by the courts, may help to clarify the position about the responsibility of an auditor for detection of fraud.

3.12 Although there have been cases in Commonwealth countries in recent years in which attempts have been made to define the scope of audit work and the duties of the auditor, the main United Kingdom cases were before the 1930s. In a more recent case—*Fomento (Sterling Area) Ltd v Selsdon Fountain Pen Co Ltd* [1958] 1 All ER 11 (HL)—which was concerned not with company audit but the audit of patent royalties—, Lord Denning said:

"What is the proper function of an auditor? It is said that he is bound only to verify the sum, the arithmetical conclusion, by reference to the books and all necessary vouching material and oral explanations, and that it is no part of his function to enquire whether an article is covered by patents or not. I think this is too narrow a view. An auditor is not to be confined to the mechanics of checking vouchers and making arithmetic computations. He is not to be written off as a professional 'adder-upper and subtractor'. His vital task is to take care to see that errors are not made,

be they errors of computation, or errors of omission or commission, or downright untruths."

This is not a novel concept, but is a reformulation of the classic statement in *London and General Bank (No 2)* [1895] 2 Ch 673.

To whom is the duty owed?

3.13 A duty is clearly owed to the company in contract. It may also be owed to the company in tort, but the position here is uncertain. There is generally no direct contractual relationship with the shareholders or any particular shareholder, although such a contractual liability could be undertaken, but the relationship, if it gives rise to liability in tort, can be regarded as 'akin to contract'.

3.14 The tests for liability in tort to shareholders and others remain unclear. There are duties owed to third parties in tort for deceit, and, more importantly, for negligent misstatement. This area of liability has been of the greatest concern to auditors in recent years, particularly because of the expanding circle of those who rely on accounts. It used to be the case that there was no liability for financial loss caused by negligent misstatement, although Denning LJ in *Candler v Crane Christmas & Co* [1951] 2 KB 164, in a minority judgment, held that auditors do owe a duty of care to a third party if they know that the accounts are required for submission to and use by him. Finally, the House of Lords in *Hedley Byrne v Heller* [1964] AC 465 decided that duties can be owed to third parties for negligent misstatement. While the House of Lords did not agree on any one test for liability, they made it clear that a special relationship created by the voluntary assumption of responsibility is required to create liability; broadly, if a person, such as an accountant, allows his advice to be passed on to another person who, as he knows or should know, will place reliance upon it, then a duty of care will arise.

3.15 The crucial question after *Hedley Byrne* was the extent of the duty of care owed to third parties and the test to be adopted to determine it. For instance, in the important New Zealand case of *Scott Group Ltd v McFarlane* [1978] 1 NZLR 553 (CA) the majority of the Court of Appeal adopted for negligent misstatement the two-stage test formulated for negligent acts by Lord Wilberforce in *Anns v Merton London Borough Council* [1978] AC 728. Prima facie, a duty of care should be imposed where damage to the plaintiff is reasonably foreseeable, but

this duty may be negated by policy considerations. Richmond P, however, formulated a narrower test based on negligent misstatement cases. He considered that the special relationship required by *Hedley Byrne* must be of such a nature that the accountant can fairly be held to have assumed a responsibility to the third party concerning the advice given. As a minimum, 'the maker of the statement was, or ought to have been, aware that this advice or information would in fact be made available to and be relied on by a particular person or class of persons for the purposes of a particular transaction or type of transaction'. The influential United States Restatement of the Law of Torts 2d Section 552 is in similar terms.

3.16 Until recently, the only English case specifically concerned with accountants was *JEB Fasteners Ltd v Marks Bloom* [1981] 3 All ER 289, which adopted the foreseeability, rather than the voluntary assumption of responsibility, test. There, Woolf J held that the auditors of a company owed a duty to a third party who took over the company relying on the audited accounts. The judge stated that the appropriate test for whether a duty of care was owed was that the defendant auditors knew or reasonably should have foreseen at the time of the audit that the accounts might be relied upon by someone seeking to take the company over. However, he qualified this test by the further requirement that the plaintiff would also have to show that he reasonably relied on the accounts.

3.17 This expansion in the range of third parties to whom duties are owed was a cause of considerable concern to accountants, as it was to other professionals. However, there has been a narrowing in the scope of tortious liability for economic loss in the past few years. Two important cases, neither of which concerned auditors, should be mentioned. In the leading speech in *Governors of the Peabody Donation Fund v Sir Lindsay Parkinson & Co Ltd* [1985] AC 210, Lord Keith emphasised the need for a relationship of proximity to exist before any duty of care can arise, and not merely foreseeability. He added, in a much-quoted dictum: "So in determining whether or not a duty of care of particular scope was incumbent upon a defendant it is material to take into consideration whether it is just and reasonable that it should be so". In *Yuen Kun Yeu v Attorney-General of Hong Kong* [1988] AC 175, Lord Keith, speaking for the Privy Council, stated that the law had developed in such a way that the test in *Anns* 'is not to be regarded as in all circumstances a suitable guide to the existence

of a duty of care'. He also said that *Hedley Byrne* 'turned on the voluntary assumption of responsibility towards a particular party, giving rise to a special relationship'.

3.18 The effect of the new more conservative climate in relation to the recovery of economic loss had not been considered in relation to negligent misstatement by auditors until the recent case of *Caparo Industries PLC v Dickman and others* [1989] 2 WLR 316. There, the plaintiff bought shares in Fidelity PLC relying on the annual accounts audited by one of the defendants. Purchases took place both before and after the plaintiff became a shareholder. A majority of the Court of Appeal decided that the auditors owed a duty to shareholders of the company who might buy and sell its shares, but not to other potential investors. The case is now on appeal to the House of Lords.

3.19 The Court of Appeal decided the case on the basis of a three part test implicit in recent economic loss cases, but only explicitly stated before in the court below. First, the loss to the plaintiff must be foreseeable. Secondly, there must be a close and direct relationship of proximity between the parties. The Court considered that there was no one test of proximity such as the voluntary assumption of responsibility or a relationship tantamount to contract, although the relationship must be a close one. Thirdly, the imposition of liability must be fair and reasonable; the court was mindful here of exposing a defendant 'to a liability in an indeterminate amount for an indeterminate time to an indeterminate class'.

3.20 A majority of the Court decided that the auditors of Fidelity owed Caparo a duty of care as a shareholder, as all three parts of the test were satisfied. On the crucial question of proximity, importance was attached to the fact that the point of the statutory requirement that accounts be audited is to supply shareholders with reliable financial information about the company. There had been a voluntary assumption of responsibility, because auditors know on appointment that their report will be sent to the shareholders who may, therefore, rely on it; in addition the relationship between the auditors and the shareholders was akin to contract.

3.21 In a dissenting judgment, O'Connor LJ, while agreeing with the three-part test referred to above, held that an auditor owed a duty to the shareholders as a body, alternatively as a class; a loss from selling shares may come within that duty, because only shareholders can sell shares, but buying shares would not do so.

3.22 The Court unanimously decided that no duty was owed to Caparo in relation to its first purchase of shares in Fidelity because before it became a shareholder there was not a sufficient relationship of proximity.

Joint and several liability

3.23 It is a basic principle of the law in the United Kingdom that, where two or more persons are to compensate another for loss, injury or damage, those persons are under a joint and several liability. The effect is that, if the claimant chooses to take proceedings against only one of those liable and obtains judgment against him, that defendant will be liable for the whole of the loss, his remedy being to seek contribution from the others. He can do this either by joining them in the original proceedings or by taking subsequent proceedings against them.

3.24 It has been very strongly represented to us that this principle operates unfairly in the case of accountants, including auditors. Frequently others, most specifically the directors of the company, contribute to the circumstances giving rise to the claim. Because the directors may not be persons of substance, and may have no or inadequate directors and officers insurance, or because the burden of proof on the part of the claimant may be higher because of what is perceived to be a lower duty of care on the part of directors, the claimant will only sue the 'deep pocket', the accountants, who will be known to carry professional indemnity insurance. The accountants, obliged to meet the full amount of the established claim, may also decide that there is no point in seeking material contribution from directors with inadequate resources. Thus, it is said, accountants bear an unfair share of the burden in practice and, further, this is reflected in negotiations for settlements.

3.25 The proposal put to us is that the liability in these circumstances should be several and not joint, ie that only a fair proportion of the loss should be the responsibility of each of those who contributed to it.

3.26 Two arguments against this might be:

- (a) that if, in cases of this kind, it was necessary for the plaintiff to mount his full case against all potential defendants in order to recover the whole of his loss, the proceedings would be even more complex, expensive and time-consuming;

- (b) that, unlike most joint tortfeasors, an auditor should be liable for the full loss if he is negligent in giving an opinion on accounts, because one of the reasons for which the auditor is employed is to check that the directors have prepared the accounts properly.

3.27 Statutory rights of contribution between joint tortfeasors were established in England and Wales by the Law Reform (Married Women and Tortfeasors) Act 1935 (and in Northern Ireland by the Law Reform (Miscellaneous Provisions) Act (Northern Ireland) 1937) and those rights continue in respect of situations arising before 1 January 1979. Wider provisions were introduced by the Civil Liability (Contribution) Act 1978 which applies (in England, Wales and Northern Ireland) to all forms of wrongdoing including breaches of contract. In assessing contribution the court is to have regard both to the culpability of the various parties and the extent to which each party's conduct 'caused' the damage in question. The respective resources or ability to pay are not relevant.

3.28 In Scotland the law as to joint and several liability is basically the same as in England and Wales. The position as to contribution by joint wrongdoers is, however, different in some respects. A right of relief exists where one person pays a sum of damages for which another person is also liable. The payer is entitled to seek a contribution towards that sum from the other person. Under the Law Reform (Miscellaneous Provisions) (Scotland) Act 1940, the court has discretion to award contribution towards the damages in such sum as it considers just. In a report dated 30 September 1988, entitled 'Report on Civil Liability—Contribution', the Scottish Law Commission has considered two problems on contribution, namely:

- (a) The scope of the 1940 Act is uncertain. It is generally regarded as providing a right of relief only between parties whose liability is in delict (analogous to tort under English law), but not between parties liable for breach of contract or any other obligation.
- (b) In order to obtain relief under the 1940 Act the claimant must have been found liable in proceedings before the Scottish courts to pay damages to the person who has suffered the loss. A settlement outside the court or the judgment of a court outside Scotland is insufficient.

The report contains detailed recommendations for legislation to deal with both these problems.

3.29 We note that the Report does not discuss the alleged unfairness of the basic principle of joint and several liability to which we refer in paragraph 3.21. In paragraph 3.7 of the Report the Commission says ... "In the first place, it is important that the law should encourage the settlement of claims." "Secondly, the law should try to achieve fairness among concurrent wrongdoers ... so that each one is liable to pay only an equitable proportion of the total loss. Thirdly, the notion of fairness among concurrent wrongdoers should not prejudice the position of the injured party. His expectation of recovering the full amount of his loss should not be affected by the number of wrongdoers who contributed to it. While it may not be possible to reconcile these three objectives in all aspects of the law of contribution, they remain, we believe, the guiding principles of reform." It might appear from this that the Commission would not have favoured a proposal on the lines mentioned in paragraph 3.22 above.

3.30 As explained above, the law of joint and several liability appears to auditors to operate unfairly in cases where they and the directors have both been negligent but the latter have inadequate resources. The position of auditors would thus be improved if more directors carried insurance. We have found that in a surprisingly large proportion of very large companies directors are now insured, in contrast to the position five years ago, but we doubt whether this is true of small and medium-sized companies. There remains some doubt about the effect of section 310 of the Companies Act 1985 (quoted in paragraph 3.3 above) on insurance policies taken out by companies for directors and officers. We believe that if this were clarified it would encourage more companies to provide such insurance. Apart from the direct benefits to directors, this would also improve the position of plaintiffs, and of co-defendants of directors. Though most claims would be settled out of court, any litigation would serve to clarify the responsibilities of directors.

Contributory negligence

3.31 Under the Law Reform (Contributory Negligence) Act 1945 (in Northern Ireland, the Law Reform (Miscellaneous Provisions) Act (Northern Ireland) 1945), where a person suffers damage partly as a result of his own fault and partly as a result of the fault of another person, any damages awarded to him will be reduced to such extent as the court thinks just and

equitable having regard to the claimant's share in the responsibility for the damage. There is a doubt as to the application of the Act to claims other than those in tort or delict.

3.32 In its Report referred to in paragraph 3.25, the Scottish Law Commission takes the view that it would, for example, be unfair, in those cases where an injured party has alternative claims in delict and contract for breach of what amounts to the same duty of care, if he could avoid reduction of damages on account of his contributory negligence simply by choosing to frame his action in contract. The Report contains recommendations for rectification of this situation, including a recommendation that the 1945 Act should be repealed and replaced with separate legislation for Scotland. It seems to us that the representations which we have received in relation to defects in the law relating to contributory negligence would be met by taking similar action in respect of the law in the other parts of the United Kingdom.

'Whistle-blowing'

3.33 The Financial Services Act 1986, the Building Societies Act 1986 and the Banking Act 1987 all make provisions in relation to supervisory bodies and auditors. While the provisions in the three Acts are not identical, the general purport can be summarised as follows:

- (a) An authorised person, whether or not a company for the purposes of the Companies Acts, may be required to produce audited accounts, the appropriate supervisory body having power to appoint an auditor if the authorised person fails to do so.
- (b) In certain circumstances a second auditor can be appointed to make a report direct to the supervisory body.
- (c) An auditor may be required to report to the supervisory body his proposed resignation or intention not to seek re-election or his decision to qualify the authorised person's accounts.
- (d) Auditors are exempted from liability for communicating certain types of information in good faith to a supervisory body, whether or not requested by the supervisory body to do so.
- (e) The supervisory body is given power to make rules for auditors to provide certain types of information to it.

3.34 We have no evidence that 'whistle-blowing' under such provisions has yet given

rise to claims, but accountants have told us that they see potential risks, particularly in relation to third parties, if they either report inaccurate suspicions to supervisory bodies at an early stage, or fail to report accurate suspicions early enough.

Incorporation

3.35 At present, auditors must practise as sole practitioners or partnerships, so that their liability generally is unlimited. In partnerships the partners have unlimited joint and several liability for partnership debts, so that a large negligence claim could not only put the partnership out of business, but could result in the individual partners being bankrupted. The present Companies Bill is intended to allow auditors to practise as limited or unlimited companies. Incorporation as a limited company would put the auditors on a similar footing to most of those with whom they deal and would mean that the personal assets of those who were not personally negligent were not put at risk. It would still be possible to sue any individual in the audit firm who could be proved to have been personally negligent as well as suing the company, though whether plaintiffs would choose to do this is open to doubt.

3.36 It is not clear whether the overall effects of a catastrophic negligence claim against a company would be significantly less drastic than the effects of a similar claim against a similar partnership. Although the principals would not be personally bankrupted, the company would be wound up and they would lose their investment and their jobs.

PART 4

International Developments

The market

4.1 We have not taken any direct evidence about the availability of professional indemnity insurance (PII) for small firms of accountants overseas; nor about their claims experience. As explained in Part 5 below, the larger firms of accountants, operating internationally, organise their insurance on a world-wide basis, and the comments which follow in this Part relate mainly to their experience.

4.2 In many countries, including France, Spain, Italy and other southern European countries, the role of the statutory auditor has not been so well-developed as in the United Kingdom. In these countries, the threat of litigation has tended to focus on international audit work which in the main will not have been statutory. There appears to be a general trend towards an enhancement of the auditor's role (possibly encouraged by the changes mentioned in paragraph 4.8 below), and this may well flow through to a consequential increase in litigation against auditors.

4.3 In some of those European countries where the position is more similar to that in the United Kingdom, such as the Scandinavian countries, there appear to be few claims against auditors and no problems in obtaining insurance. In others, such as Belgium and the Netherlands, the history of claims is not extensive, but there are signs of an increase and insurance cover is proving costly.

4.4 In the United States the number, nature and size of claims are causing problems for accountants, and these seem still to be increasing. Constant initiatives are undertaken by the professional bodies seeking to limit liability. The position in Canada is broadly similar, though not so extreme. Hong Kong is experiencing a run of severe litigation, and Australia's experience is such that there are initiatives to try to limit liability (see paragraph 4.10 below). In each of these four countries, accountants face the same problems of sharply changing premiums and inadequate available insurance as in the United Kingdom.

Law

4.5 The countries with a well-developed statutory audit function tend to be those with legislative systems based on common rather than civil law. In most if not all of those systems, the two tenets of unlimited liability and joint and several liability apply. In addition, in the United States, the treble damages capable of being awarded against accounting firms under the Racketeer Influenced and Corrupt Organisations laws have been a major problem for auditors. In a small number of countries, such as the Federal Republic of Germany, there is a limit on liability in respect of statutory audits, but, as business becomes more international, such limits may become less effective in practice.

4.6 The International Bar Association submitted to the study team a copy of a report 'Professional Indemnity Insurance: Proposals for Legislation' (extracts at Annex 8) which was prepared by a committee of experienced European and American lawyers and was adopted by the Association's general meeting in Buenos Aires in September 1988. The report deals with professions generally and deals in most detail with developments in the United States. Of particular interest is the information on the responses by individual States to the recommendations of the Tort Policy Working Group established by the US Government and which reported in 1986: 16 States had to some extent implemented a recommendation that the doctrine of joint and several liability should be eliminated; and a number had introduced some system of capping liability, but only in relation to personal injury cases or others involving non-economic loss.

4.7 The questions of statutory limitations and contractual limitations are being explored in a number of countries where the liability of auditors is currently unlimited. No such changes have yet been made, but the best developed proposal of which we are aware is the Australian one described below.

4.8 The programme of company law harmonisation in the European Community contains a

number of Directives which affect or will affect the contents of accounts or the qualification of auditors, but there are no proposals which directly deal with liability or insurance. A Directive adopted last year on the mutual recognition of higher education diplomas will also affect auditors, in that it will make it easier for accountants who have qualified in one Community country to practise in another. We see no reason, however, to expect any of these changes to have a direct effect on auditors' liability in the United Kingdom, but they may contribute to the development of the auditors' role in the Community countries described in paragraph in paragraph 4.2 above.

‘Capping’: the Australian proposal

4.9 In September 1986, the Australian Companies and Securities Law Review Committee submitted a report to the Ministerial Council on the civil liability of company auditors. This recommended a statutory limitation of auditors' liability. The Ministerial Council asked the National Companies and Securities Commission to prepare a detailed scheme of limitation, which they did in 1987. So far no action has been taken on the report, but it represents the best attempt of which we are aware to overcome the practical difficulties of devising a reasonable and workable capping system.

4.10 The NCSC working party recommended that the maximum potential liability of an auditor ‘...to all persons arising from each ‘event’ in the nature of an audit, the subject of litigation,...’ should be limited according to the following table:

<i>Audit fee</i>		<i>Statutory cap</i>	
Nil	to A\$1,000	A\$200,000	
A\$1,001	to A\$5,000	A\$500,000	
A\$5,001	to A\$20,000	A\$1m	
A\$20,001	to A\$50,000	A\$1m	to A\$2.5m
A\$50,001	to A\$100,000	A\$2.5m	to A\$5m
A\$100,001	to A\$500,000	A\$5m	to A\$10m
A\$500,001	to A\$1m	A\$1m	to A\$20m
In excess of A\$1m		Greater of A\$20m and ten times fee	

The minimum statutory cap (A\$200,000) coincided with the cover required at that time by the Australian Society of Accountants.

4.11 The working party recommended that, as a condition of acting as an auditor, an accountant should be required to have non-cancellable PII on a scale which would enable him to meet a claim for the largest amount for which he could be liable under the capping system on the basis of the largest fee actually charged in the previous five years, with one reinstatement, so that he would be able to pay

such a claim twice in any one year. They also recommended that:

- (a) each auditor should be required to maintain such PII for six years after retirement;
- (b) there should be a minimum prescribed deductible;
- (c) the definition of whether claims relate to the same event should be the same in the PII policies as in the statute defining the cap;
- (d) the cap in relation to the audit of a holding company should be based on the aggregate of audit fees of that auditor for all the companies in the group;
- (e) if a claim cannot be met in full by insurance because an individual auditor has provided false or misleading information to his insurer or because of any other wilful, deliberate or fraudulent conduct of the auditor, then that individual should personally have unlimited liability, but any partners, principals or employees who were not knowingly concerned with such conduct should retain the protection of the statutory cap;
- (f) if a claim cannot be met in full because of (i) an inadvertent failure on the auditor's part to comply with the terms of his insurance, or (ii) the insolvency of the auditor's insurer, then the statutory cap should apply, though the auditor would still be personally liable up to that limit.
- (g) any legal costs should be excluded in determining the amount to be made available to plaintiffs, so that the amount of the statutory cap should be available in full for damages only.

Professional Indemnity Insurance

5.1 Accountants do not carry separate insurance policies for audit work, so that the descriptions below apply to insurance which also covers the other services they provide (described in paragraph 2.8 above).

5.2 The differences between the large and small accountancy practices described in paragraph 2.6 above are reflected in their insurance arrangements and experience. Although the hardening of the insurance market in 1985 to 1987 affected professional indemnity insurance (PII) for all accountants, the way in which it affected them was markedly different for large and small practices.

The experience of smaller practices

5.3 Our survey of auditors (see Annex 5) showed that 99 per cent of partnerships, but only 80 per cent of sole practitioners, have PII cover. The main reasons given by the 20 per cent for not having cover were that they saw no need for it (11 per cent) or that the cost was too high (8 per cent). Only 2 per cent of partnerships and none of the sole practitioners found that they could not obtain all the cover they required. 85 per cent of partnerships and 66 per cent of sole practitioners who expressed a view said that they regarded the cost of PII as unreasonable.

5.4 The brokers who deal with smaller practices including sole practitioners told us that premiums for a typical practice more than trebled between the beginning of 1985 and mid-1986, remained stable to the end of 1987, and have been falling since then. This movement, and its relationship to fee income, is illustrated in the table at Annex 9.

5.5 At the same time as premiums rose sharply in 1985-86, the extent of cover was reduced. Although the brokers confirmed our survey findings that smaller practices have had no significant difficulties in obtaining the overall level of insurance cover they seek, the policies changed in the following ways:

- (a) Formerly the cover limit was for each and every claim—this changed to an

aggregate cover limit (eg a practice with £1 million cover would formerly have been insured for any number of claims within that limit, but by 1986 the insurance would have been exhausted once the total claims in the year had reached £1 million). The policy conditions generally allow for one reinstatement of cover when the aggregate limit has been exhausted.

- (b) The typical self-insured deductible in relation to each claim (ie that part of any claim to be met by the practice rather than the insurers) rose from less than 1 per cent of fee income to between 2 per cent and 3 per cent. In 1984 it was possible to buy cover with no deductible, but from the second half of 1985, some deductible became unavoidable.
- (c) Legal costs, which the insurers had previously met in addition to the indemnity limit of the cover, came to be included in the overall policy limit (thereby reducing the amount of insurance available to meet the claim).

In the softening market, these changes have recently been to some extent reversed.

5.6 Many of the smaller firms were understandably aggrieved by the sudden increases in premiums, particularly those firms which had good claims records, and many felt that they were being unfairly penalised because of the large, publicised claims against the larger firms. We have seen the aggregate results of the premiums, claims and payments for a representative number of smaller firms, and we believe that the premiums were uneconomically low in the early 1980s and that the increase thereafter can be fully explained as the market's reaction to the poor experience of insurance for the smaller practices. The market does appear to have over-reacted in 1985 and 1986, and it is now readjusting.

5.7 We believe that the experience of the scheme run by Bowring for the Institute of

Chartered Accountants in England and Wales up to the end of 1988, covering about one third of accountancy practices in England and Wales, is not untypical of the experience of insurance for smaller practices. In that scheme, audit work gave rise to less than 10 per cent of the number of claims, but these represent almost 30 per cent of the aggregate of sums paid and of sums reserved (ie the amounts estimated by insurers to be likely to be paid on claims already being processed). The average size of claims for audit work is higher than for any other type. Bowring have told us that their experience in running the Scottish Institute's scheme is broadly similar.

5.8 The premiums for each practice are based on its annual fee income, but are adjusted by either a credit or debit depending on a number of factors, including its mix of different types of work, its claims record, its largest single client, and any work done overseas, particularly in North America. The Bowring scheme also took into account the responses to a quality control questionnaire, circulated separately from the insurance proposal form.

Intermediate-sized practices

5.9 We believe that what we have said about smaller practices will be true for partnerships with annual fee income up to around £15 million. Of the twelve or so firms with annual fee income of between £15 million and £100 million, most have extensive international affiliations and/or large listed company clients; and thus these firms have problems similar to those of the Big 8 described below in obtaining adequate cover. However, their relatively smaller turnover means that they would be less well able to cover a very large claim which exceeded their total coverage or to arrange self-insurance on the same scale as the Big 8 (see paragraph 5.35 below).

5.10 On the other hand, those firms in this category who have no overseas or very large clients find their experience is closer to the smaller partnerships, in that they can purchase the cover which they consider adequate. As with many of the smaller practices, the cost of that insurance appears to them to be excessive in terms of their good past claims record. However, the insurers justify the cost on the grounds of the risk of larger future claims—one major loss could outweigh several years' premiums from all the firms in this group.

Experience of the eight largest accountancy firms

5.11 All of the Big 8 international accountancy firms buy all of the insurance cover they

can obtain in the market and have done so for many years. The costs of premiums vary considerably, depending on the self-insured deductibles which they accept. The cover is denominated in US dollars, and each firm co-ordinates its insurance arrangements with the other firms in its grouping. For example, a number of these firms share certain aspects of their PII arrangements world-wide with some or all of the overseas firms in their international grouping. It is possible, therefore, that in the event of a claim in the UK, either the deductibles or the policy limits may have been eroded by claims paid or reserved in another area.

5.12 In contrast to the smaller practices, the main concern of the Big 8 has been the availability of cover rather than the cost. The amount of cover available has reduced in two ways: first, the maximum amount covered, which had grown faster than fee income for policies renewed from 1978 to 1984, fell back sharply in 1985, and fell further in 1986. Since 1987 the maximum cover has been less than half of the 1984 peak, while over the same period, average fee income of the UK firms has more than doubled and there has been a substantial increase in the size of many of their client companies. These maximum levels are provided on an each claim basis, though they have always been subject to aggregate limits.

5.13 The second way in which the amount of cover has been reduced is that since 1985 they have been able to purchase in the commercial market only a proportion of coverage at each level. (For example, in a particular year, the commercial insurance market might be willing to cover only 60 per cent of the band between \$20 million and \$40 million.) At the lower levels of cover, the full effect of this was initially deferred by a policy condition whereby, if certain insurers wish to withdraw but others do not offer to take over, the original insurers will continue to provide coverage for a further limited period. (Unlike some other types of insurance, PII is generally bought on a 'claims made' basis—ie the year of coverage applicable is determined by the date of notification to the insurers of the claim or of the circumstances giving rise to the claim.)

5.14 As with the small practices (paragraph 5.5 above), the quality of coverage has also changed. In addition to the larger deductibles on each and every claim, the firms have also had to bear greatly increased self-insured aggregate deductibles before insurance coverage applies. This can be higher than 10 per cent of the UK firm's annual fee income (though is

likely to be shared with other firms in the international grouping). As for the smaller firms, the legal costs came to be included in the overall policy limit.

5.15 A number of the Big 8 have for some time had their own internal insurance arrangements to fund the self-insured retentions before commercial insurance attaches. In order to fill the further gaps in their coverage (described in paragraph 5.13 above), they have adopted the following measures:

- (a) In 1986, they formed a mutual insurance company, Professional Asset Indemnity Ltd (PAIL) the effect of which is to build up a fund to meet shortfalls in cover. This company fills out the uncompleted shares in the higher layers on the same terms and conditions as the commercial market.
- (b) In 1987, most of them participated in setting up PADUA Ltd to provide mutual cover for shortfalls at lower levels of cover.

5.16 The highest UK settlement to date is only slightly lower than the current level of cover available; and one claim involving audit work in the United States (but not against a Big 8 firm) has been settled for substantially more than the present maximum level (though within the relevant coverage, ie the cover at the time when the circumstances giving rise to the claim were notified to the insurers). The accountants and their insurers are concerned that there is a real risk of an award being made which would exceed the cover now provided by the commercial insurance market and seriously impair the funds available through the self-insurance and mutual funding schemes.

Reasons for these trends

5.17 The insurance market as a whole is affected by general economic variables such as inflation and interest rates. It is also, of course, affected by the incidence of very large individual claims such as those caused for example by natural disasters such as hurricanes and earthquakes or by serious products claims from such causes as asbestos. The period from 1982 to 1984 was undoubtedly the worst for insurers' underwriting results in recent years, and this was particularly true in North America and in the international reinsurance market which at that time provided significant support to the then substantial limits of coverage purchased by the Big 8 firms.

5.18 Accountants' professional indemnity claims occur more frequently when there is an

economic down-turn such as a recession or a period of high interest rates. Because professional indemnity settlements follow the events giving rise to them by a number of years, the underwriting cycle tends to be particularly marked. When insurers are reporting good underwriting results, it encourages additional investment in the industry leading to increased underwriting capacity. The high interest rate period in the middle 1970s encouraged insurers to accept more business than was sensible at uneconomic prices in the belief that they could compensate for unsatisfactory underwriting results by high interest earnings on premiums collected. When towards the end of the 1970s insurers realised their mistakes and rapidly increased premiums, it attracted a significant number of new companies into the international insurance and reinsurance business. Consequently this led to the period when accountants, in common with many other insureds, were able to obtain very high limits of insurance. However, due to the over-gearred position of the insurance and reinsurance market, with lead insurers often retaining very little of the risk, these high policy limits were somewhat artificial and unsustainable.

5.19 The period of rapid expansion in insurance availability at uncompetitive rates in the early 1980s was followed by very bad underwriting results in 1982-84. These underwriting results caused many insurers and reinsurers either to withdraw from the business altogether or substantially to restrict their capacity, bringing about a very tight phase of the underwriting cycle in 1985-88, when there were very large premium increases for accountants' PII (as for most insurance premiums) combined with a reduction in the limits available to them.

5.20 When there is a shortage of capacity generally, the amount available for PII will reduce, not only in proportion to the general lack of capacity, but more sharply because insurers will prefer to deal in risks which are inherently more predictable (eg motor or property insurance) or with which they are more familiar (eg ships and aircraft).

5.21 Between 1983 and 1988 at least 19 major insurers of accountants' professional indemnity withdrew from the market. The bad underwriting results generally sustained by the international reinsurance community coincided with an unprecedented number of serious claims against accountants which made the situation even worse. Moreover, insurers also felt that new interpretations of professionals' legal duties extended auditors' responsibilities and

raised the standards of care required, exposing auditors to greater and undefined liabilities. This also was reflected in reduced capacity and increased premiums.

Summary

5.22 The major causes of the recent trends both in the United Kingdom and world-wide therefore seem to be:

- (a) a general lack of adequate profit in the insurance market, leading to a particularly sharp fall in capacity in difficult risks, particularly including PII;
- (b) the normal cyclical hardening in the PII market, following the soft market from 1980 to 1984, when premiums became unprofitably low;
- (c) increasing claims against accountants, including some very large and well-publicised ones;
- (d) court decisions which suggested that accountants and other professionals had wider liabilities than previously thought, but leaving the legal position uncertain.

PART 6

Litigation and Claims

6.1 We have no doubt that the potential liabilities of auditors as well as the size and number of actual claims have increased very substantially over the years. The reasons for this include:

the business world has become more complex and sophisticated, partly reflecting the trend in the UK economy away from manufacturing towards services, particularly financial services;

the potential losses involved have increased in real terms far faster than the rate of growth of companies or of accountancy firms; this is particularly so in relation to acquisitions fifteen years ago companies above a certain moderate size were thought to be safe from takeovers;

the profession itself has set higher standards for its members to attain.

Each publicised claim against an auditor, whether it involves court proceedings or is settled out of court, seems to induce others to consider the possibility of making such a claim. Since many plaintiffs, often themselves public companies, are publicly accountable, there is pressure on them to make claims on any grounds available, if only to demonstrate that they have taken every step available which may result in the making good of a loss incurred.

6.2 The auditor cannot limit his liability to the company and its shareholders, and so his liability must be regarded as unlimited. In practice he probably cannot limit any liabilities to other readers of the accounts, which for all limited companies are a public document, available for public inspection at Companies House. Potentially the figures can materially exceed the market capitalisation or net tangible asset value of the company concerned. For example, in the case of banks or other financial services companies, with gross liabilities which can be a large multiple of net assets, total claims could in theory be the amount of or even exceed those gross liabilities. It is also possible that damages for the same loss can be awarded to

more than one party, for example both to the company and to a shareholder.

6.3 Many of the accountants we have consulted have stressed the burden which defending large claims, even successfully, puts on their practices. The financial costs of defending claims have increased for a number of reasons: apart from the increasing number and size of claims, and the general increase in the cost of legal services, more time must be spent on each claim, both because the claims are generally more complex and because even for a similar claim the preparation will now be more extensive than it was some years ago. These costs can now run into several millions of pounds.

6.4 Although if successful the accountants will recover a substantial part of their external legal costs (to the extent that the plaintiff is able to meet them), they will not recover any of their internal costs in time spent by partners, management and internal lawyers. Outstanding large claims also could have an adverse effect on morale and reputation. All of these factors put pressure on defendants to reach a settlement rather than to fight the case.

Effect on Provision of Services

7.1 The increases in claims and settlements or awards, in the cost of insurance, and in the exposure of those firms unable to obtain what they consider to be adequate cover has a number of effects on the way the accountants provide services.

Costs of audit services

7.2 The costs to the accountants are increased in the following ways:

- (a) they now pay higher insurance premiums (paragraph 5.4 above);
- (b) a higher proportion of settlements or awards is not covered by commercial insurance so that either they pay more of each settlement, or they contribute to a mutual or captive (Part 5 above);
- (c) they have higher external costs of defending claims (paragraph 6.4 above);
- (d) the unrecoverable, internal cost of defending claims has increased (paragraph 6.3 above);
- (e) they may carry out more extensive audit procedures (paragraph 7.4 below).

7.3 It is not possible to measure the extent to which these costs are passed on to clients, but they have a significant impact on the costing structure of the large firms of accountants.

More extensive auditing

7.4 Accountants are more conscious of the risk of claims for negligence, and this is likely to have two effects on the way in which they provide audit services. First, the auditor may carry out more extensive checks—if auditors were previously carrying out inadequate checks, this would represent an improvement in the service, but there may be a level of checking beyond which no purpose is served other than to protect the auditor in the event of a claim.

7.5 A second possible change is that auditors may more often qualify their audit reports. There does not appear to have been any change for larger companies. But there does seem to have been an increase in relation to small companies, where many auditors have been

using a form of words contained in Example 6 of an Auditing Guideline issued by the professional bodies in 1980. This is used in connection with small companies and appears to be an attempt to disclaim responsibility on the grounds that the auditor has had to rely on assurances from the management of the company, but with no indication to the reader of which items in the accounts have not been independently verified. The Auditing Practices Committee, noting that more than half of qualified audit reports were in this form and the criticism of it, is currently replacing the relevant Auditing Guideline with an Auditing Standard effective for audit reports dated on or after 1 September 1989.

Rejection of categories of clients

7.6 Many accountants are less willing to take on clients who seem to them to raise particular risks of claims. Our survey shows that, for around 20 per cent of partnerships (and 25 per cent of sole practitioners), there are categories of business for which they would not accept new audit business. Of these, roughly one third have actually refused to accept new business because of the prospect of liability, and a very few (less than 3 per cent of partnerships and 4 per cent of sole practitioners) have stopped auditing some existing clients.

7.7 To the extent that accountants are avoiding clients whom they do not have the expertise to audit, and there are other accountants better able to cope with these clients, this may be an improvement. But we have heard from some of the larger firms, with a comprehensive range of expertise, that they are turning away potential clients whom they perceive to be more likely than average to result in negligence claims. If this practice becomes widespread, then the result may be that companies which are seen as posing risks of this kind may find it difficult to appoint an auditor, or may appoint a firm with less comprehensive expertise.

Difficulties in recruiting partners

7.8 The potential personal liability of partners may be a disincentive to an accountant

accepting a partnership. While we have received no evidence that any offer of partnership has been refused on these grounds, some firms have said that they believe it is a factor in the decisions of some partners and potential partners to take jobs in industrial or commercial companies rather than remain in practice as accountants.

Summary

7.9 Some of these influences have good as well as adverse implications for clients and other users of accounts but if claims continue to increase, and particularly if one of the largest partnerships were to be obliterated by a large claim beyond its insurance cover, then they would be likely to increase to the point where they would significantly reduce the value of the audit service. If one of the Big 8 partnerships failed in this way, then quite apart from the direct disruption caused to its clients, the effect on the rest of the profession would be considerable. Accountancy could suddenly become a much less attractive career option and recruitment would suffer. Those who were offered partnerships might think twice before accepting. It has been represented to us that the impact of such a failure could lead to the end of the independent and highly-qualified audit service which plays an essential role in the British business community.

PART 8

Key Issues

8.1 We have been impressed by the quality and consistency of the evidence we have received. The scope of our study being statutory audit work and other statutory reporting meant that we were able to focus our investigations and we are satisfied that we have been able to form a wide-ranging, detailed and worthwhile view of the situation.

Increasing claims

8.2 Claims against auditors have been increasing in number and size. When large businesses collapse nowadays it is normal for those who have suffered loss and are looking for recompense to examine the position of the auditor.

8.3 We do not believe that this is a reflection of falling standards on the part of auditors—on the contrary, the profession has been making efforts to improve training and standards, but in the field of litigation this simply has the effect of raising the benchmark of the care and skill expected of an auditor. The reasons rather are a widespread assumption that the audit report is a guarantee or warranty of the accuracy of accounts and the soundness of the company; and the knowledge that accountancy firms carry substantial professional indemnity insurance (PII).

Scale of liability

8.4 Unlike other professions, and unlike accountants involved in non-audit work, auditors are prevented from negotiating contractual limits to their liability with their clients (paragraph 3.3 above). The sheer scale of the potential claims against auditors is striking: claims could substantially exceed the value of the company audited (paragraph 6.2 above).

Uncertainty of potential plaintiffs

8.5 A further difference between auditing and most other professional services is the public nature of the accounts and the audit report, which means that the auditor can be found to owe a duty not only to his client, the company, but also to a wide and uncertain range of third parties which can include individual shareholders, prospective purchasers, banks and other creditors. It is hoped that the *Caparo*

case, on appeal to the House of Lords, may provide some further clarification of those to whom a duty is owed (Part 3 above).

Insurance

8.6 We have found that the problems faced by large and by small auditors are different in nature. Smaller accountancy firms have generally been able to obtain as much insurance cover as they want; the largest firms have been unable to do so, particularly in the last four years.

8.7 No insurance policy for accountants will ever cover the cost of compensating for the gross liabilities of a large bank or the takeover value of a large public company. The relative uncertainty of the risks run by accountants also means that, at times of general shortage of capacity in the insurance market, the costs of accountants' PII rise sharply and the availability of cover is reduced. At present it seems that, after the last hardening of the market, costs are falling but the insurers are unwilling to go back to providing the previous high levels of cover.

Costs of protection

8.8 The need for accountants to protect themselves against unlimited liabilities when adequate insurance is not available imposes considerable costs on them and to some extent therefore on their clients (paragraph 7.2 above).

Outstanding risk

8.9 The unlimited nature of auditors' liabilities means that each accountancy firm is exposed to the risk of obliteration. Attempts by accountancy firms to limit the risk imposes not only financial costs on them and their clients, but can also be expected to have adverse effects on the way they carry out audits. If a small practice were obliterated, it would be awkward for its clients and most unfortunate for the practitioners, but arrangements could probably be made for its work to be taken over by another firm. If one of the largest firms were obliterated it would be more difficult to organise such a rescue, and it is likely that many large

companies would be put to considerable expense and inconvenience in arranging interim measures for the audit or re-audit of their accounts, and in relation to other services provided by the accountancy firm. Such an event would also highlight to all accountants the risks they are running and would be likely to have a long-term effect on the way in which audits were carried out. In addition and most importantly, it would have a damaging effect on recruitment to the profession for some considerable time.

Current developments

8.10 The environment in which auditors operate has been changing recently, and there have been a number of developments relevant to this study:

The Companies Bill introduced to Parliament in December 1988 is intended to make auditing much more tightly regulated.

It is still too early to see what effect the 'whistle-blowing' provisions of the Financial Services Act 1986 and other legislation will have on liability claims.

From the beginning of 1990, there will be compulsory insurance for all practising accountants (paragraph 2.4 above).

The insurance market has been softening: PII premiums are falling towards the levels of 1984, and other terms and conditions are improving. However, the cover available from the market for very large claims has not increased.

The *Caparo* case, now on appeal to the House of Lords, may clarify the extent of auditors' duties to third parties.

8.11 It seems likely that the first three of these developments will encourage the public to believe that there will always be someone solvent to sue if they suffer loss when a company collapses. On the basis of past insurance cycles, we would expect the market to harden again at some time in the early 1990s. The *Caparo* case may set limits to the uncertain range of people to whom auditors may be liable, but the Court of Appeal judgment would mean that the auditor can be liable to anyone who acquires a company provided only that he had at least one share before the audit report in question.

PART 9

Possible Next Steps

9.1 In the course of our study, we have heard and considered a number of proposals. We describe below the extent to which we believe these would reduce the problems identified above.

Insurance

9.2 Although the cost and availability of insurance are important factors in the problems identified, we have heard no proposals which would directly tackle this aspect. We believe that there is no option but to continue to allow market forces to determine what insurance is provided. Accountancy firms are now involved in self-insurance to various extents, including captive insurance companies and mutual schemes: these may help to compensate for the unavailability of coverage when the commercial insurance market is hard, but they will not be a complete solution to the problem. If other steps are taken to reduce the exposure of accountants, this may be reflected in an increased willingness of insurers to provide cover.

Litigation

9.3 As for all commercial litigation, the time and expense involved in defending professional negligence claims in the courts are considerable, but we have heard no proposals that would directly reduce this and doubt whether any changes in court procedure solely for cases involving auditors would be possible or desirable.

Joint and several liability

(a) Change in the general law

9.4 It has been suggested that, when other parties share responsibility for a loss, it is unfair that the auditor should be liable to pay the full amount if the others are in relative terms not worth pursuing on economic grounds. A widespread proposal is that the auditor should be liable only for that proportion which he would be liable to pay if the other potential defendants had the funds to make an appropriate contribution and to meet their own costs.

9.5 We have considered this (see paragraphs 3.23–30 above) and we do not believe that, in

an attempt to alleviate the position of auditors, it is realistic to consider a change for them alone to the basic legal principle that a plaintiff should be able to recover damages in full from any one of the parties responsible. In any event, although such a change would seem fairer to the auditors, it would still not eliminate the risk of obliteration of a firm by a catastrophic claim. It seems to us that any change in the general law in relation to joint and several liability should follow consideration of it by the Law Commission who could look at it in a wider context and with more detailed consideration of the effect of a change than we have been able to do.

(b) Directors and Officers insurance

9.6 The auditor's position would, however, be improved if he were not the only defendant with adequate resources or insurance which is often the position at present. We believe that if more company directors were insured then they might be able to make a contribution to a loss if appropriate, and they would at least have the resources to meet their own costs if they were joined as codefendants by auditors and if they were found to share responsibility. We are aware that the Department of Trade and Industry consulted widely in early 1988 on the question of reforming section 310 in this respect, but at the date of this report the Companies Bill contains no provision to reform it. We recommend that section 310 of the Companies Act 1985 should be clarified to allow companies to buy insurance for their directors, and officers. It is for consideration whether some encouragement should be given to directors and officers insurance: we do not believe that compulsory directors and officers insurance for large companies would be realistic or desirable; but the admissibility of the costs for taxation purposes would be an important factor in providing such encouragement.

Contributory negligence

9.7 We support the Scottish Law Commission's recommendation that the Law Reform (Contributory Negligence) Act 1945 should be amended or replaced so as to make clear that contributory negligence by a plaintiff is relevant to awards in contract as well as in tort or delict,

and we believe this should be done for all parts of the United Kingdom (paragraph 3.32 above).

Discretionary reduction of damages

9.8 It was suggested to us that it was wrong that the auditor who is found to be liable, whether solely or jointly with others, for negligence should always be liable in full for all damages (being unable to limit his liability because of section 310 of the Companies Act 1985) even though in the circumstances this might be seen as manifestly unfair. One proposal which addressed this was a recommendation that the courts should have discretion to reduce the award to whatever proportion seemed fair, taking into account all the circumstances, including the degree of negligence, the auditors' insurance cover and the comparative ability of each party to bear the loss. Inevitably such a change would introduce yet another layer of uncertainty to the outcome of cases.

Limitation of liability

(a) Incorporation with limited liability

9.9 As we noted above (paragraph 3.35), the proposal in the current Companies Bill to allow auditors to incorporate as limited or unlimited companies would enable the members of an accountancy partnership to become shareholders and directors of a limited company and so protect their personal assets (except for those who are personally negligent). But it would not prevent the practice from being obliterated by a catastrophic claim.

9.10 In the event, it seems that few of the major accountancy firms intend to incorporate. There are a variety of reasons for this, including the differences in the taxation of partnerships and companies and in particular the significant tax costs of converting a partnership to a company.

(b) 'Capping' liability

9.11 The proposal that the liability of auditors should be limited in relation to each audit is the one which most directly minimises the risk of obliteration by a single catastrophic claim. The best developed proposal we have seen is the one prepared by a working party of the Australian National Companies and Securities Commission in 1987, described in Part 4 above.

9.12 We have to say, however, that we see considerable difficulties in such a proposal: first, when the cap operates it will prevent plaintiffs from recovering the full loss they have suffered, and most directors and users of accounts naturally feel that this would be unfair. Second, even the carefully considered

Australian scheme does not overcome all the practical difficulties—for example, auditors would be required to carry PII which would enable them to pay in aggregate twice the level of the cap which would apply to their largest single audit fee. If they were faced with three such claims in relation to one year, then not only could the accountancy firm be obliterated, but not all of the successful plaintiffs would be able to recover the amount of the cap (which would already be lower than their loss). Bearing in mind that it could take very different lengths of time to establish both liability and quantum in respect of the various claims, the effect would probably be first come, first served.

(c) Allowing agreed limits

9.13 The proposal to amend section 310 of the Companies Act 1985 by exempting auditors so as to allow each company and auditor to negotiate and agree a limit of liability would put the provision of audit services on the same footing as other contracts. Whether limits were agreed and at what level would depend upon market forces, particularly the cost and availability of insurance, the attitudes to risk of the clients and auditors, and competition among auditors.

9.14 It would be possible to specify minimum or maximum limits, either absolutely or linked to the size of the company, the audit fee or the availability of insurance. We believe, however, that it would be best to leave the contracting parties free to negotiate the limit. Where appropriate, the Unfair Contract Terms Act 1977 would apply. We see no reason why auditors should have a special position in relation to that Act. If the Act is unsatisfactory, this is something which is likely to concern all providers of goods and services, not merely auditors.

9.15 We believe that any such limit would be sufficiently important to shareholders that it should be included in the resolution appointing the auditor, and shown in the accounts.

9.16 This proposal would not necessarily eliminate the risk of obliteration through catastrophic claims, but it would give accountancy firms the ability to limit their liability contractually in the same way as others presently can.

Terms of Reference

In the light of current concern about the cost and availability of professional indemnity insurance and the extent of professional civil liability for negligence, to establish the facts about the effect on the following professions of the way the law operates in providing remedies to those who suffer loss as a result of the way in which a professional person performs his duties:

- (a) auditors (and other accountants in independent public accounting practice who carry out reporting functions arising out of statutory requirements);
- (b) architects/consulting engineers/construction surveyors;
- (c) other surveyors (such as land surveyors and mining surveyors).

The studies should in particular:

- (i) Examine the nature of the service provided by the professions listed above, the professional duties and liabilities arising from that service, including the extent to which there are requirements to conform to professional standards and guidelines; the way in which the service is held out to the public; and public expectations and understanding of the service provided;
- (ii) Obtain detailed information about recent trends in the availability and cost of professional indemnity insurance for the profession listed above, and the reasons for these;
- (iii) Obtain detailed information about how the law has operated in the past and how it currently operates in relation to actions in negligence against members of professions listed above;
- (iv) Consider international developments with particular reference to the European Community and the extent to which they have affected, or may affect, (i), (ii) and (iii) above;
- (v) Assess the effects, now and in the future, of (i), (ii) and (iii) above on the availability, quality and cost of the services provided by the professions listed above, and the impact on those who rely on the service provided by members of these professions and to assess the effects of (i), (ii) and (iii) above on the effectiveness and competitiveness of these professions;
- (vi) If appropriate, suggest possible next steps for future consideration of the subject.

Composition of the Study Team

Chairman: Bill Morrison deputy senior partner, Peat Marwick McLintock; former President of the Institute of Chartered Accountants of Scotland

Members: Tony Mallinson formerly senior partner, Slaughter and May

 Robin Jackson director, Merrett Underwriting Agency Management Limited

 Geoffrey Williams deputy Chairman, J Henry Schroder Wagg & Co Ltd

Secretary: Richard Grafen Department of Trade and Industry

Insurance Brokers who Provided Evidence

Bowring Accountants' Insurance Services Limited (formerly part of Bowring Professional Indemnity Limited)

Bradstock, Blunt and Thompson Limited

Hinton Hill and Philipps Limited

Minet International Professional Indemnity Limited

Survey of the Hundred Group

Letters and questionnaires were sent to members of the Hundred Group of finance directors, in order to obtain the views of users of audit services: finance directors are users both as employers of auditors and as people who read other companies' accounts.

Of the 134 members, 67 replied, and the questions and an analysis of the responses are given below.

Question 1: name and address

Question 2: To what extent do (or should) investors and others base decisions on annual accounts (a) in extending credit, (b) in mounting takeovers, (c) in other investment decisions?

The responses ranged from 'not at all', to 'totally', but most seemed to believe that, while annual accounts would rarely be the only piece of information used, they would normally be the single most important basic input. Generally, the responses argued that it was important that investors and others should be able to rely on the annual accounts. There was no common view that accounts were more or less important for anyone of the three categories of decision (a)–(c). Few respondents distinguished between what investors and others do and what they should do.

Question 3: To some extent accountants (and the companies they audit) are paying the cost of general insurance of the correctness of the accounts not only for the companies themselves but also for some third parties. Is this fair and efficient?

Yes	67 per cent
No	16 per cent
N/A	16 per cent

Question 4: (a) Do you believe that directors should carry insurance? (b) Do you have Directors & Officers (D&O) insurance? (c) Would more widespread D&O cover relieve the perceived problem?

	Yes	No	N/A
a)	76	15	9
b)	61	33	5
c)	36	58	6

Question 5: Have you observed any changes in auditors' attitudes recently, such as a more defensive attitude?

Yes	27
No	72
N/A	1

Question 6: What do you think the effect would be of proposals to reduce auditors' exposure, for example (a) by capping their liability at a fixed level or a multiple of fees? (b) where the blame can be apportioned between various parties, by making the auditors liable only in proportion to their share of the responsibility, even if the other parties are unable to pay?

Most respondents (34 out of the 67) believed that capping would have adverse effects, many believing that it would lead to a reduction in standards of auditing and in the protection given to

shareholders and other users of accounts. Of those who believed that capping would have positive effects (18), some said that it would lead to lower audit fees. The remaining 15 respondents divide into those who believe capping would have mixed effects, and those who believe it would have negligible effects.

Most respondents (37 out of 67) believed that changing the law of joint and several liability in relation to audit claims would have positive effects, and would be equitable and reasonable. The 17 who opposed such a change included those who said that it was more important that those who had suffered loss should have adequate redress.

Survey of the Auditors

Methodology

Questionnaires were sent to random samples of sole practitioners and partnerships. The samples were drawn from membership lists supplied by the ICAs, ACCA and AAPA. The largest 20 firms were excluded, and three hundred sole practitioners and 450 firms were selected. We received 98 usable returns from sole practitioners and 146 from firms.

A copy of the questionnaire is attached.
The results are given by number of respondents except where otherwise stated.

Results for sole practitioners

Question 2:

Number of partners	not applicable
Average number of other chargeable staff	1.7
Average aggregate fee income	£44,400

Question 3:

Average percentage of fee income generated by audit/attest work	32 per cent
---	-------------

Question 4:

a) Do you have professional indemnity insurance (PII) cover?	Yes	78
	No	20
b) Reason for not having PII:		
— not able to obtain it	0	
— cost too high	11	
— see no need for it	8	
— some other reason	1	

Question 5:

Did you take all the cover available?	Yes	42
	No	37
If not, this was because:		
Did not need it	Yes	24
	No	5
Too expensive	Yes	17
	No	2
Was all the cover you required available?	Yes	77
	No	0

Question 6:

Over the last five years, has PII become		
easier to obtain	10	
more difficult to obtain	14	
neither of these	51	
Over the last five years, has PII become		
less expensive	6	
more expensive	62	
neither of these	8	

Question 7:

Do you regard the cost of insurance as reasonable?	Yes	27
	No	53

Question 8:

Categories of work for which:

	Yes	No	n/a
stopped auditing existing clients	4	92	2
have refused new audit business	9	85	4
would not accept new audit business	25	70	3
Adapted procedures or staff training	18	76	4
Other effects on firm	14	75	9

Question 9:

	Yes	No
Claims in last five years	4	93
If yes, did any involve a court hearing	0	4
for last settled claim:		
No insurers involved	0	4
Final payment:		
Nothing	1	
Within excess	1	
Larger amount within insurance	1	
Larger amount not covered by insurance	0	
Not stated	1	
Did it involve a court judgment?	Yes	0
	No	2
	n/a	2

Results for partnerships

Question 2:

Number of partners	4.2
Average number of other chargeable staff	17.3
Average aggregate fee income	£521,000

Question 3:

Average percentage of fee income generated by audit/attest work	37
---	----

Question 4:

a) Do you have professional indemnity insurance (PII) cover?	Yes	145
	No	1
b) Reason for not having PII:		
— not able to obtain it	0	
— cost too high	0	
— see no need for it	1	
— some other reason	0	

Question 5:

Did you take all the cover available?	Yes	62
	No	82
	n/a	2
If not, this was because:		
Did not need it	Yes	61
	No	5
Too expensive	Yes	37
	No	8
Was all the cover you required available?	Yes	137
	No	3
	n/a	6

Question 6:

Over the last five years, has PII become	
easier to obtain	11
more difficult to obtain	52
neither of these	82
Over the last five years, has PII become	
less expensive	11
more expensive	128
neither of these	3

Question 7:

Do you regard the cost of insurance as reasonable?	Yes	21
	No	121

Question 8:

Categories of work for which:	Yes	No	n/a
stopped auditing existing clients	4	140	2
have refused new audit business	11	133	2
would not accept new audit business	30	114	2
Adapted procedures or staff training	91	55	0
Other effects on firm	33	91	22

Question 9:

	Yes	No
Claims in last five years	49	97
If yes, did any involve a court hearing	4	43
For last settled claim:		
No insurers involved	11	35
Final payment:		
Nothing	11	
Within excess	15	
Larger amount within insurance	10	
Larger amount not covered by insurance	1	
Not stated	8	
Did it involve a court judgment?	Yes	2
	No	26
	n/a	6

Notes on question 8

Of those who answered yes to all or part of question 8(a), many did not specify which type of businesses they were or would be unwilling to audit, but merely said that they were now more discriminating. Some related their willingness to the size or status of the firm, ranging from sole practitioners who would only audit small companies where the shareholders were the directors, to those who drew the line at public or listed companies. The only two more specific categories mentioned by more than one respondent, were subsidiaries of United States or other overseas companies (mentioned by 4 of the 262 respondents), and companies in the financial services area (mentioned by 6).

The most common changes cited by those who replied yes to question 8(b) or (c) were tighter procedures, involving variously fuller documentation including engagement letters, more involvement by more senior personnel, more use of audit manuals. A number also said that they now spent more on training for staff, and that in training more emphasis was now put on the avoidance of liability. Some said that they were now more guarded and cautious when giving advice generally.

Professional Liability Questionnaire

Form PLA Q

Please tick correct boxes

1 Please give full name and address of your firm

Name

Address

Postcode

2a Please give the number of

Partners

Other chargeable staff

£ '000

2b and the Aggregate Fee for the last financial year (include commissions and sundry income but exclude VAT)

3 Approximately how much of your fee income is generated by audit and other attest work relating to statutory requirements?

%

4a Do you have professional indemnity insurance cover?

If Yes go to Q5

If No, please answer Q4b then go directly to Q8

4b Is your reason for not having professional indemnity insurance cover that:

You are not able to obtain it?

You regard the cost as too high?

You do not see any need for it?

Some other reason?

5a When you last renewed your professional indemnity insurance:

did you take up all the cover available?

If Yes, please go to Q5b

If No was this because

you did not need it?

it was too expensive?

1
4
8
14
16
17
18
19
20

5b Was all the cover you required available to you?

Yes

No

6 Based on your firm's experience over the last five years, has professional indemnity insurance become

a) easier to obtain?

more difficult to obtain?

neither of these?

b) less expensive?

more expensive?

neither of these?

7 Do you regard the cost of indemnity insurance as reasonable?

Yes

No

8a Has the prospect of professional liability affected your firm's willingness to take on work so that there is now a category of business for which

you have stopped auditing existing clients?

If Yes please give details

you have refused to accept new audit business?

If Yes please give details

you would not accept new audit business?

If Yes please give details

21
22
23
24
25
26
27

8b Has the prospect of professional liability caused you to adapt your procedures or staff training in any way? Yes ☐ No ☐

28

8c or affected your firm in any other way? Yes ☐ No ☐

29

If Yes (8b or 8c) please give details

10 Would you be willing to take part on a confidential basis in a follow up questionnaire or private discussion? Yes ☐ No ☐

35

If Yes please give your name and daytime telephone number

Name

Daytime Tel No

9a Has your firm experienced professional liability claims in the last five years? Yes ☐ No ☐ If No go to Q10

30

● Did any of these claims involve a court hearing? Yes ☐ No ☐

31

9b In relation to the last settled claim

● did you deal with it yourself, without involving insurers? Yes ☐ No ☐

32

● was the final payment

nothing? ☐ 1

an amount within your excess? ☐ 2

a larger amount covered by insurance? ☐ 3

a larger amount not covered (or not wholly covered) by insurance? ☐ 4

33

● did it involve a court judgement? Yes ☐ No ☐

34

11 Please add any further comments which you feel might help the Study Team. These need not be restricted to the issues covered in this Questionnaire.

Thank you for completing this Questionnaire.

Please return to : Mr M Doxsey
Department of Trade and Industry
Companies Division
Room 515
10 – 18 Victoria Street
London, SW1H 0NN

in the reply envelope provided

Broad Comparison of UK Fee Income with
Worldwide Fee Income

	Fee Income		Ratio
	UK £M	World-Wide £M	%
KPMG Peat Marwick McLintock	263	2294	11.5
Price Waterhouse	179	1305	13.7
Coopers & Lybrand	172	1305	13.7
Deloitte Haskins & Sells	151	1130	13.3
Ernst & Whinney	121	1289	9.4
Touche Ross	117	1082	10.9
Arthur Andersen	113	1659	6.8
Arthur Young	108	1208	8.9
Grant Thornton	75	424	17.7

Sources:
UK fee income — 'The Accountant', June 1988
World-wide fee income — 'International Accounting Bulletin', December 1988

Notes:
Includes fee income from all sources including audit work.
The fee incomes are quoted for different twelve month periods in each source.
The International Accounting Bulletin quotes the worldwide fees in US dollars, which have been converted at £1=\$1.70 for comparison.

Sections 236 and 237 of the Companies Act 1985

Auditors' report

236—(1) A company's auditors shall make a report to its members of the accounts examined by them, and on every balance sheet and profit and loss account, and on all group accounts, copies of which are to be laid before the company in general meeting during the auditors' tenure of office.

(2) The auditors' report shall state:

- (a) whether in the auditors' opinion the balance sheet and profit and loss account and (if it is a holding company submitting group accounts) the group accounts have been properly prepared in accordance with this Act; and
- (b) without prejudice to the foregoing, whether in their opinion a true and fair view is given:
 - (i) in the balance sheet, of the state of the company's affairs at the end of the financial year,
 - (ii) in the profit and loss account (if not framed as a consolidated account), of the company's profit or loss for the financial year, and
 - (iii) in the case of the group accounts, of the state of affairs and profit or loss of the company and its subsidiaries dealt with by those accounts, so far as concerns members of the company.

Auditors' duties and powers

237—(1) It is the duty of the company's auditors, in preparing their report, to carry out such investigations as will enable them to form an opinion as to the following matters:

- (a) whether proper accounting records have been kept by the company and proper returns adequate for their audit have been received from branches not visited by them,
- (b) whether the company's balance sheet and (if not consolidated) its profit and loss account are in agreement with the accounting records and returns.

(2) If the auditors are of the opinion that proper accounting records have not been kept, or that proper returns adequate for their audit have not been received from branches not visited by them, or if the balance sheet and (if not consolidated) the profit and loss account are not in agreement with the accounting records and returns, the auditors shall state that fact in their report.

(3) Every auditor of a company has a right of access at all times to the company's books, accounts and vouchers, and is entitled to require from the company's officers such information and explanations as he thinks necessary for the performance of the auditor's duties.

(4) If the auditors fail to obtain all the information and explanations which, to the best of their knowledge and belief, are necessary for the purposes of their audit, they shall state that fact in their report.

(5) If the requirements of Parts V and VI of Schedule 5 and Parts I to III of Schedule 6 are not complied with in the accounts, it is the auditors' duty to include in their report, so far as they are reasonably able to do so, a statement giving the required particulars.

(6) It is the auditors' duty to consider whether the information given in the directors' report for the financial year for which the accounts are prepared is consistent with those accounts; and if they are of opinion that it is not, they shall state that fact in their report.

Extracts from 'Professional Indemnity Insurance: Proposals for Legislation'

Adopted by the International Bar Association's General Meeting in September 1988

"In recent years the cost and availability of professional indemnity insurance have been causing increasing problems in the western world generally and in particular in the United States of America. The United States Government established a Tort Policy Working Group consisting of officials of Federal Agencies presided over by an Assistant Attorney General (Richard K Willard). In 1986 the Working Group issued a Report entitled 'Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Current Crisis in Insurance Availability and Affordability', and in March 1987 issued a further Report entitled 'An Update on the Liability Crisis'. The nature of the anxiety felt by the United States Government is accurately reflected in the title of these Reports. A single statistic will be sufficient to indicate the gravity of the situation: in 1985 premiums for doctors practising in obstetrics/gynaecology averaged \$51,420, being 51.6 per cent of net income. Obviously premiums of this nature have had a dramatic effect. A survey conducted by the American Consulting Engineers Council revealed that 19 per cent of consulting engineers were practising without insurance cover. A survey conducted by the State Bar of California concluded that nearly half the State's lawyers in private practice carry no insurance and a member of the American Bar Association's Standing Committee on Lawyers' Professional Liability has said that in the United States as a whole the figure is 20-45 per cent. Problems of availability and affordability have been contained to some extent as a result of higher deductibles, lower coverage limits and additional Policy exclusions and limitations. There has also been increasing reliance on self insurance and captive insurance programmes although it is too soon to say whether these will result in greater availability of cover or less cost. As the Working Party put it:

'Despite some assertions to the contrary, the impact of the crisis in insurance availability and affordability continues to be felt—often acutely—throughout much of the American economy'.

Although the problem has not become as acute in other developed countries it is serious and, in our view, will become increasingly so. It is now impossible to obtain adequate cover for the largest risks and, in addition to lawyers, it is an acute problem for architects, consulting engineers and accountants. There are claims pending or threatened which, if successful, would result in bankruptcy of all the partners in some of the largest firms of solicitors and accountants in the world.

The gravity of the situation in the United States of America led to the Working Group making a number of far-reaching recommendations:

"1) 16 States implemented in various ways and to a differing extent a recommendation that the doctrine of joint and several liability be eliminated."

"2) The Working Group recommended that damages for non-economic loss should not exceed \$200,000. States have enacted legislation to cap non-economic damages in sums ranging from \$250,000 (Colorado) to \$875,000 (New Hampshire) while 5 states have enacted limitations for medical malpractice cases in sums ranging from \$225,000 (Michigan) to \$1,000,000 (Wisconsin and West Virginia)."

"3) The Working Group recommended that the collateral source rule prohibiting the consideration of the offset of collateral benefits, be modified or eliminated and this has been done in 11 States."

“Of course, any legislature which is considering any limitation on damage will have regard to the interests of the consumer, which in this case means the person who is claiming damages. However, by ‘consumer’ what is meant is an individual in his private capacity. The man in the street or his family needs to be able to recover damages for death, injury and the value of his home and contents. Outside the United States, professional people are able to obtain cover at reasonable rates in respect of those risks. The risk of bankruptcy arises when a professional person is sued by a Limited Company or Central or Local Government. The concept of Limited Companies was introduced because it was thought right to limit the liability of participants in such Companies. It is ironical that professional people should be at risk of bankruptcy at the hands of shareholders in Limited Companies who themselves have the advantage of personal immunity from suit if the Company cannot meet a judgment against it. It is suggested that this is an obvious anomaly.”

“Attempts have been made in various countries to obtain legislation to cap damages but these have tended to have been made by individual professions rather than by the professions acting in concert. In our view it is plain that any capping of damages should not apply only to selected professions, as has been done in some of the States in America in respect of doctors, but must apply to all professions. Indeed we consider it most unlikely that any legislation of the kind proposed would be acceptable unless it extended to people who are not members of a profession. For example, there seems no reason why an architect should have the benefit of any limitation of damages but that a self-employed builder should not and the injustice would be manifest if both are sued in the same action. In our view the protection of any such legislation should be extended to anyone who wishes it, provided he obtains the necessary insurance and agrees to the provisions relating to exclusion and limitation of liability. We consider that legislation along these lines would be just.”

Illustrative Table of Premium Changes for a Medium-Sized Practice

On the basis of evidence we have received from brokers dealing with small and medium-sized accountancy firms, we have been able to construct the following table showing the premiums which would be paid by a typical firm which had an annual fee income of £100,000 in 1984 and 10 per cent growth thereafter. In practice, there will have been a wide variation in actual premiums paid, depending upon a number of factors, including the characteristics of individual firms and of their insurance policies.

<i>Policy renewed in:</i>	<i>Annual fee income</i>	<i>PII premium</i>	<i>Premium as %age of fees</i>	<i>%age change in premium over previous year</i>
	£	£	%	%
mid-84	100,000	1,000	1.0	—
mid-85	110,000	2,000	1.7	100
mid-86	121,000	3,500	2.9	75
mid-87	133,000	4,000	3.0	14
mid-88	146,000	3,400	2.3	-15
mid-89	161,000	2,400	1.5	-30

Report of the Construction Professionals Study Team

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Annexes

The following annexes, which are not included in the published report, contain the basic data from which the report was derived.

Annex A	Insurance
Annex B	The Legal Background (The Capper/Uff report, revised by Professor Philip Capper)
Appendix B1:	Paper submitted by Beale and Company —Developments and changes in the law affecting professional negligence
Appendix B2:	Letter from the Office of Fair Trading— Disclaimers
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Appendix B4:	Case studies
Annex C	International Comparisons
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Annex F	Analysis of Formal Submissions
Annex G	Statistics of Construction Output
Annex H	Records of the Official Referees Court

The Annexes are available on request from the Construction Directorate, Department of the Environment, 2 Marsham Street, London, SW1B 2EB.

Executive Summary

0.1 Background

The Study Team was appointed in May 1988 to examine the effect on the construction professions of the way the law and insurance operates in providing remedies for those who suffer loss as a result of a professional person's duties. The professions reviewed were architects, building services engineers, building surveyors, civil engineers, structural engineers and quantity surveyors.

Before stating the Study Team's principal conclusions and recommendations, two matters must be emphasised.

Firstly, although some of the services of construction professionals are between one consultant and one client, the great majority are an integral part of an industrial process which is unique in that clients commission temporary coalitions of, on the one hand, consultants and, on the other, contractors, specialist sub-contractors and suppliers for the purposes of single projects. Clearly, these arrangements pose problems that are not faced by other professions.

Secondly, construction practice is changing rapidly. During the course of the review, the Study Team was told of the very much reduced role of scale fees in negotiating commissions, of the extent of component construction and the growing involvement of specialist sub-contractors in design and of the increased demands now being placed on contractors offering design services. Each has an influence on professional roles and on clients' prospects of redress. Taken together, and if the current direction of change is maintained, they will materially affect the deployment, roles and liabilities of consultants. Moreover, legal practice and the law have not stood still. The use of collateral warranties imposed on consultants has become more widespread, the scope for actions in tort has been reduced and the validity of disclaimers has been addressed by a recent decision of the House of Lords.

0.2 The Principal Findings

The Professions

The activities of construction professionals range from the highly specialised to the very

general. Moreover, their services are offered in very different ways, by, for example, sole specialists, consultants employing 1,000 professional staff or more and working at the leading edge of technology, small local practices and public service organisations. The study made no attempt to enumerate or classify these activities. Rather, an attempt was made to understand and forecast the implications for professional liability of the many changes that have taken place or are in train.

Interdependence

Interdependence is one of the dominant characteristics of construction. In building, interdependence has grown as contractors' and specialists' responsibilities for design have developed and as component building has replaced much of conventional construction. Although it is less important in civil engineering, because there are fewer parties and the main contractor is likely to execute much of the works, the contributions of client, consultants and contractor are nevertheless intertwined.

Typically, the many parties—perhaps more than 100 for a major project—will have different formal conditions of engagement, contract or supply, often with intermediate parties having different liabilities to, for example, the main contractor or the client. Moreover, roles and responsibilities change as projects progress and the work of one participant affects and is affected by the work of others. Many specialists are able to impose their own conditions of engagement on contractors, which may or may not marry with those of others.

Attitudes

Clients' attitudes are now more commercial than they were, with private sector clients insistent on completion on time and within budget and with public sector clients concerned more with value-for-money in the short term rather than with the whole life cost. Professionals believe they now face a more hostile world. Their experience is that many clients set out to impose onerous conditions and to transfer risks to them which they are not able to control and that they are now more likely to be joined in multi-party litigation.

Technology

Construction is now more demanding because performance requirements are more exacting. On average, projects are larger and many are technically complex. Some innovation is deliberate. Much is involuntary, to meet new situations or to find substitutes for materials that are no longer available. There are three effects. Professional roles and tasks are changing, some advanced design skills now reside with specialists and the task of coordination is more demanding.

Professional Services

The evidence of the review is that these arrangements, complex as they are, work well enough when experienced clients play their proper role and take care to appoint experienced and adequately resourced consultants and contractors. Coordination is then less difficult and problems are more easily anticipated. Moreover, such clients normally have realistic expectations and use their market strength to achieve negotiated settlements, turning to litigation only as a last resort.

Other less expert or less good clients may be unwilling or unable to fulfil a client's role, thus throwing more responsibilities on their consultants. They may also have unreasonable expectations. When matters go awry, they are less able to negotiate, either because they lack the experience or because their management finds it too difficult to make the unpalatable decisions that are often needed to achieve a negotiated settlement.

Fault-free professional services cannot be guaranteed. Informed professional judgement may be mistaken or contradicted by events which neither a client nor a consultant can control. Lapses and mistakes happen and, of course, some consultants are less committed or less competent than others. Nevertheless, the evidence is that the great majority of clients responding to this review were content with the quality and reliability of professional services. They were less satisfied with the quality of projects, which is, of course, the outcome of a range of inputs, many of which are beyond any consultant's control.

0.3 Do the Current Arrangements for Appointing Consultants, Allocating Risk, Settling Disputes and Making Redress...

...generate trust?

In an increasingly commercial world and in their search for certainty and risk limitation, clients and consultants are adopting defensive

tactics as a matter of course. These may be advantageous when they lead to greater clarity. They are damaging when cooperation is stifled and risks are transferred to those who cannot control them.

...promote quality?

Fear of litigation, reinforced by well publicised cases, has made many consultants acutely aware of the advantages of systematic quality management. Informal procedures have been codified, there is greater commitment to continued professional development and more consultants are considering applying for Quality Assurance (QA) certification.

...promote efficiency and competitiveness?

Roles in construction are inevitably intertwined. Experience suggests and research has demonstrated that cooperation and a participative style of management lead to increased efficiency and fewer mistakes. As trust evaporates, cooperation and participation are less likely and both may be further impeded by defensive tactics. Almost certainly, efficiency and competitiveness are reduced when commitment to a project's success has been eroded by cost cutting and risk transfer.

...encourage innovation?

Much innovation is imposed by the necessity to meet a client's brief, to comply with new statutory requirements or to substitute for materials that are no longer available. Current apprehensions and uncertainty about liability have caused both clients and consultants to be wary of innovation, which is now attempted only if time and resources permit searching investigations. Also consultants are—or should be—now alerted to their duty to advise clients when a necessary innovation entails unusual risks.

...influence the management of projects?

Conditions of engagement are increasingly taking more time to negotiate, since many are peppered with non-standard conditions devised by individual clients. More clients now set out to impose increasingly onerous conditions, including indemnities. There is a dramatic growth of demands for collateral warranties, some of which greatly enlarge professional liability. When these much amended standard conditions have been accepted, consultants may be accepting risks which they are not able to manage. The result is likely to be a further increase in litigation.

Doubt breeds doubt. Risk transfer by clients is countered by consultants' defensive design and

by further risk transfer. The strong impression is that these attitudes now characterise much of construction and contribute nothing to efficiency, competitiveness and quality.

...influence consultants' management?

Coerced by their clients' insistence on tighter control of time and budgets and by reduced fee income arising from fee competition and negotiation, consultants have responded by investigating fewer options, adopting simpler design solutions and transferring more detailed design to specialist sub-contractors. It has, however, not been shown that these trends have either reduced or increased their liability.

Some large practices have become incorporated. A variety of reasons are advanced; for example, financial and taxation advantages, tighter management control and a reduction of partners' personal liability for the activities of other partners. Retired directors are also less vulnerable to claims against their personal assets or estates than are retired partners. As far as can be discerned, clients are not disadvantaged.

...constrain the development of the industry?

As has been explained, many factors are now influencing the way in which clients obtain the industry's services and the roles of consultants and contractors are changing. In practice, there is no barrier to entry. However, all new arrangements pose risks. When the law and the likelihood of redress are both highly uncertain, these additional risks may inhibit developments that are needed for the industry to be fully effective.

...create an efficient framework for containing and settling disputes?

Formal litigation is viewed with abhorrence by clients and consultants. It diverts senior management's attention, incurs irrecoverable costs and is protracted and uncertain. Fear of the consequences of becoming enmeshed in litigation encourages the parties to settle before writs are served. In particular, experienced clients use their market strength to negotiate settlements, reserving litigation for large claims (in excess of £1½m in the case of one major developer).

Less experienced clients may blunder into litigation which cannot be justified by the outcome. More use should be made of conciliation. A short arbitration system for claims of up to £50,000 would provide a better response to the needs of occasional and domestic clients.

...lead to an intolerable volume of litigation?

Despite the widespread apprehensions of clients and consultants and the number of claims notified to insurers, the risk of a writ being served in respect of any project is small and the risk of a court hearing is very small.

Evidence about the probable volume of litigation in the foreseeable future points to increasing litigation, partly because of all the uncertainties that now operate and partly because of the potential for litigation created by much amended conditions of engagement and onerous collateral warranties.

...lead to fair settlements?

Clients may be affronted when they discover either that no producer is liable for a damage suffered, that the action is time barred or that defendants lack funds. Consultants strongly believe that they are often made responsible for the liabilities of others and that the combination of unlimited liability, high levels of Professional Indemnity (PI) insurance cover and the law regarding joint liability and contribution encourages claims against them. This, they believe, obliges them and their insurers to pay for an unreasonable share of negotiated settlements and awards.

...protect consultants' interests?

On the evidence of this study, PI insurance effectively protects consultants' interests. However, the increases in premiums have resulted in PI insurance being the most costly overhead for about 50 per cent of the consultants responding to the review and the second most costly overhead for a further 30 per cent. The PI insurance market is now softer; when next it hardens, PI insurance could become even less affordable for many consultants, unless higher deductibles are accepted. This puts them at risk when one project is the subject of several distinct claims. Finally, insurance capacity, although not now a problem, could quickly become one were insurers and re-insurers to withdraw again from the PI insurance market.

...protect clients' interests?

PI insurance is not in place to protect clients' interests. If they cannot accept the risk of not being able to obtain timely redress, they should directly insure their own risks. This is important because, as has been emphasised, the current arrangements do not ensure that clients have a certain route to redress, even if all the possible defendants are available and have adequate funds to meet their potential liabilities.

0.4 The Problem

Risk allocation

With all development and production, risk is inevitable. In manufacturing industry, all production functions and the risks entailed normally fall to the management of a single organisation. They include decisions about what is to be produced, design, quality, production methods and quality control. In construction, these functions are widely distributed. Clients, consultants, contractors and a myriad of sub-contractors, specialists and suppliers all operate in situations that do not repeat. It is little wonder that risk allocation and the attendant liabilities and rights of redress are major problems and that clients and consultants are apprehensive and uncertain.

Ideally, risks are best allocated to those best able to control them. Indeed, this fairly describes the attitudes of the experienced 'good' clients who contributed to the review and of the consultants and contractors they regularly employ. Repeated experience engenders trust. Together they create confidence and certainty.

The search for certainty

In normal circumstances, the search for certainty bears differently on clients and consultants. Consultants need to be sure of the responsibilities they have undertaken and the liabilities they incur. This is not impossible when one consultant provides a service. It is much more difficult when there are several consultants, with interwoven tasks, whose designs are brought to fruition by contractors, sub-contractors and specialists with whom they may have little contact and over whom they can exercise no effective control. Established practice, aided by cooperation and common sense, normally makes these risks manageable.

Clients need to be certain of their route to redress should contracts run late, overspend, be of unacceptable quality or develop latent defects. Such certainty is not possible. The many producers will be liable in different ways and will have different relationships, actual and implied. Some causes of damage may involve either an external agency or no breach of duty. Thus, even when clients have taken the greatest care to safeguard their interests, redress is far from certain. This is the crux of their problem.

In their search for certainty, clients are now creating unprecedented contractual liabilities for consultants to an array of third parties. In particular, collateral warranties often set out to create a new category of potential plaintiffs who

were not party to the construction process and will know nothing of its circumstances. It is clear that the full effects of such liabilities have yet to be felt and that their implications are not yet generally understood by consultants or by their insurers. Therefore, consultants cannot be certain of effective PI insurance cover when these new liabilities materialise.

When matters go awry, clients, again in search of certainty, will join all producers who may have been liable, unless there is a producer with ample funds or insurance who is clearly to blame. A selected defendant will almost certainly join other potential defendants in third party proceedings, because this will be cheaper and less time consuming than separate contribution proceedings. Whatever the route, the effect is the same: those who can, pay. Often, those paying will be consultants, who are more likely to have a continuing existence and the near certainty of PI insurance. In this way, consultants and, to a lesser extent, contractors of substance pay for the faults of others.

The basis for reform

The interwoven responsibilities and liabilities of those engaged in construction are such that reform based on the liability of construction professionals alone cannot resolve every problem. If it is accepted that the combination of unlimited professional liability, high levels of PI insurance cover, and the law relating to joint liability and contribution has the effect of making consultants prime targets for litigation, and that the effect is counter productive to clients' interests, a comprehensive solution to professional liability would entail legislation to ensure:

- capped liability;
- mandatory PI insurance;
- equitable risk sharing;
- more certain time limitation; and
- that defendants in commercial cases not involving personal injury should only be responsible to the plaintiff for damages equivalent to that part of the plaintiff's loss fairly attributable to the breach.

The Study Team accepts the desirability of comprehensive reform, which would lead to more efficient risk sharing, but draws back, mainly because legislation to cap the liability of construction professionals would raise complex issues of public policy, probably requiring a review of the liability of other professions, which could be a major remit for the Law Commission. This could postpone any reform

for several years. Moreover, the current negotiations leading to the Single European Market may eventually involve legislation which would impinge on that needed to achieve a comprehensive solution in the United Kingdom for the construction professions alone.

The Study Team makes two complementary groups of recommendations: action by the professions and their clients and legislation. Recommendations for better practice, which can be implemented by professional institutions and consultants' associations in collaboration with their clients, will go a long way to creating the confidence and greater certainty sought by clients and consultants alike. The legislation recommended below is essential if the current erosion of trust and confidence is to be stopped and the benefits of better practice are to be fully realised.

0.5 The Study Team's Principal Recommendations

(i) *Improved Quality and Risk Management*

The objectives of improved quality and risk management, clarity of responsibilities and greater certainty in law can be pursued immediately, through initiatives by the institutions and associations representing clients, the professions, consultants and insurers. The recommendations invite them to, *inter alia*:

- establish a trans-professional short arbitration procedure which would mainly serve the interests of occasional and domestic clients;
- devise reformed and unified consultants' conditions of engagement;
- work with others to align the consultants' conditions of engagement and the standard conditions of contract;
- review the arrangements for regulating the standards of professional competence of members;
- consult about the possibility of devising guidelines:
 - for limiting the liability of professionals, commission-by-commission, by agreement with their clients; and
 - for limiting the liability of a defendant to a plaintiff to a just and equitable proportion of the damages suffered, when there is more than one defendant and they have not acted jointly; and

- play a more active role in providing quality management and risk management advice.

(ii) *Time Limitation*

The Study Team recommends that serious consideration be given to alterations in the law to make the time limitation on liability certain. This proposal is supported by all the institutions and associations and by the British Property Federation.

The proposal is:

To amend in English law the Limitation Act 1980 and thus the provisions introduced into the 1980 Act by the Latent Damage Act 1986, and in Scotland the Prescription and Limitation (Scotland) Act 1973, to achieve the following:

- a limitation (prescriptive in Scotland) period of ten years from the date of practical completion or effective occupation (staged if necessary) for negligent actions in tort (delict in Scotland) and in contract (whether or not under seal);
- the ten years limitation period acting as a longstop extinguishing the right;
- redefinition of the term 'deliberate concealment' so that ordinary construction processes would not lead to an exception to the longstop.

These statutory provisions, although part of general law, are crucial to construction litigation because of the importance of latent defects. The principle of a decennial limitation period is already part of English statute law. This was established by the Consumer Protection Act 1987 which itself was a consequence of European Community legislation. If Ministers accept this recommendation, amending legislation could be deferred until negotiations preparing for completion of the Single European Market are well advanced, since these themselves may lead to legislation which will affect liability in the construction industry.

(iii) *Joint Liability*

The Study Team recommends that serious consideration be given to the alteration of the law in commercial cases, not involving personal injury, where the plaintiff's claim exceeds, say, £50,000. In such cases, a defendant whose actions are partly the cause of damage to the plaintiff, but were not carried out jointly with another defendant, should be responsible to the plaintiff only for damages equivalent to that part of the plaintiff's loss fairly attributable to his or her breach.

This recommendation is strongly supported by the professional institutions and consultants' associations. The British Property Federation accepts that the current law can be unfair to consultants. Clearly, this recommendation, of crucial importance to the construction professions, raises issues of public policy which may need to be considered by the Law Commission.

SECTION 1

Introduction

1.1 Background

In October 1987, Francis Maude, then Parliamentary Under Secretary of State for Corporate and Consumer Affairs, commissioned three fact-finding studies in the light of the concern about professional liability and PI insurance. The studies were commissioned to investigate the problems of construction industry professionals, auditors and non-construction surveyors. This is the report of the Construction Industry Study Team.

The terms of reference, common to all three study teams, are at Appendix 1. The teams were asked to establish the facts about the cost and availability of PI insurance, the extent of professional liability for negligence, and the way in which the law operates. The study teams were also asked to consider how these matters might affect the professions and the services they offer and, where appropriate, to suggest possible reforms.

The professions considered by the Construction Industry Study Team were architects, building surveyors, civil engineers, quantity surveyors, services engineers and structural engineers. These professions offer an extensive range of services, from small structural surveys to large and complex development projects.

The members of the Construction Industry Study Team were appointed in an individual capacity in May 1988, to represent clients of the industry, the professions and contractors, together with an insurance expert and a legal expert. The Study Team's membership and details of its secretariat, provided by the Department of the Environment, is at Appendix 2.

The value of construction work in the UK in the twelve months to September 1988 was just over £39 billion. Annex G provides details of construction output. Savory Milln and the Cambridge Econometrics Group have both predicted that construction output will continue to grow faster than the economy as a whole, at least until the year 2000. The quality and reliability of professional services will have an important bearing on how this demand will be met from the resources within the UK.

1.2 Types of Service

It is necessary to distinguish between project and non-project related services although, of course, many professional practices provide both, sometimes consecutively, when, for example, a feasibility study leads to the design for a project.

Non-project professional services usually involve one client, one consultant and one activity. Most end with a forecast or a report, for example a feasibility study, a building or structural survey, or a site investigation. The formal requirements of a brief, a proposal, and negotiations leading to a commission are often not fulfilled, with, perhaps, the work being agreed by telephone and briefly confirmed by letter. Some of these services entail advanced and sophisticated techniques, commissioned research and development. Many depend on informed judgement, because funding or time will not allow a full enquiry or crucial facts are necessarily uncertain, as with estimates of tender prices.

Most professional services in construction are project-related, involving several consultants working in temporary coalitions for the purpose of a single project, with their work being brought to fruition by other temporary coalitions of contractors, sub-contractors and specialist sub-contractors with design responsibilities. In addition, components and materials may be obtained from a myriad of component manufacturers and suppliers.

When completed, construction projects are subject to all the vagaries of ground movement, climate, usage and quality of maintenance, sometimes giving rise to faults for which the owner may seek compensation from the designer. Moreover, construction litigation is often multi-party with inter-related and ill-defined responsibilities and uncertain facts, all adding significantly to the cost, commitment and time needed to resolve disputes.

1.3 Method of Study

The method of study had three stages: collection of evidence, evaluation and reconciliation

of differing views and definition of proposals for reform. Evidence was obtained from four principal sources: formal submissions from professional institutions and associations, summarised at Annex F; a questionnaire survey of professionals, contractors, clients, insurers and brokers, summarised at Annex E; a survey of the records of the Official Referees Court, at Annex H; and interviews with a wide cross-section of interested parties, which included regional visits and intensive sessions on specialised topics.

The information obtained from these sources was analysed by the Study Team's secretariat and reviewed by the Study Team, which met on 12 occasions. Possible reforms were considered and ordered in terms of priority. Time and resources limited the size of the sample, which is small in relation to an industry with a £39bn turnover. Nevertheless, information obtained from the various sources showed a broad measure of agreement and the views expressed in this report are considered to be adequately representative.

The study concentrated on sole practitioners and independent consultants. No examination was made of public service organisations or of the liability of their employees. This is because of rapid change in the public sector, involving not only clients served by professional offices remaining in the public sector but also the transfer of these offices to independent or quasi-independent status. No doubt these new arrangements will safeguard adequately the liability of employees.

The report is in two parts. The first presents the evidence and data obtained by the Study Team in summary form and develops the arguments for reform leading to the Team's recommendations. The second (not published here) provides detailed annexes on key aspects of the study and on statistical data from various sources.

SECTION 2

The Construction Industry and the Nature of the Services Provided

2.1 Foreword

Professional liability in the construction industry is an important aspect of the procedures of an industry which is complicated and diverse. To be understood and assessed properly, and for valid reforms to be proposed, professional liability must be set in context.

2.2 Perspective of Professionals

There is no reliable, comprehensive information about the number of construction professionals or their deployment. The number of those qualified, about 160,000, provides little guidance. Many professionals are members of more than one institution, some practitioners are not in membership and others follow non-construction vocations. Some professionals operate as sole practitioners, while others are directly employed by contractors, the manufacturing industry, commerce or the public sector. The majority work within partnerships or incorporated companies.

Professional practices vary in size, from the sole practitioner to those with almost 2,000 professional staff. Many practices responding to the questionnaire survey were involved with more than one professional discipline. Almost 22 per cent were truly multi-disciplinary. Some of the larger practices form project teams from single discipline divisions; others operate as small multi-disciplinary practices within a group. The majority of the larger practices has specialist departments, such as advanced structural analysis, site investigation and research and development. These often market their services to others, in addition to meeting the needs of their parent organisation.

In recent years, many larger practices, in particular civil engineering consultants, have become incorporated as limited companies. Division of an unwieldy partnership into a number of more efficient, self-managing companies within the umbrella of the group was reported as the principal advantage, together with potential gains in pensions treatment and taxation. Fears about the cost of meeting the requirements of company law were said to be

unfounded and more than offset by the operational advantages. Partnerships which have become incorporated find that staff, formerly buried under layers of senior partners, partners and associate partners, are much more enthusiastic once they are part of an identifiable, small, self-determining company. Directors are less liable personally than are partners and are better protected when they retire. It is also commonly believed that an incorporated structure is more easily protected against a predatory plaintiff, although parent company guarantees are often used to circumvent this tactic.

The professions are uneasy at the way in which relationships with their clients have changed. These changes, they believe, are to the detriment both of their clients and of the broader interests of the community. Their principal concerns, the subject of this section, are examined in greater detail in Annex F.

In recent years, in the south east especially, the industry has been experiencing a boom, with major practices flourishing, new practices becoming established and contractors often operating at full stretch. Consequently, the professions and contractors have been generally able to resist clients' attempts to impose more stringent conditions and increased liability. Two examples bear this out. Firstly, since the Lords' ruling on the *D&F Estates* case ⁽¹⁾, many clients have attempted to impose collateral warranties, in response to the now much reduced scope of actions in tort. The more onerous have been resisted by alert consultants, often backed by their PI insurers, but others have accepted liabilities which may void their PI insurance policies. Secondly, developers have found contractors reluctant to accept the wider design responsibilities envisaged in the British Property Federation system ⁽²⁾, except at a price. In both instances, matters may have been very different had the workload remained depressed.

In whatever way construction resources are brought together, managed and rewarded, the following are the principal stages of a conventional construction project involving different disciplines:

feasibility studies
 development of the brief
 preliminary design and evaluation
 obtaining planning approval
 design development and specification
 obtaining approval under building regulations
 mobilisation of on-site resources
 deployment and management of resources
 quality management
 commissioning
 handover
 defects liability.

The above list does not represent a sequence of activities, each being completed before the next is started. Activities are interdependent and iterative. Moreover, a less than adequate performance by one participant can create additional tasks for others and management can become overwhelmed by the volume of the work entailed in resolving uncertainties and correcting mistakes. Attempts to define liability precisely must fail. Construction has many discontinuities and inter-relationships, which change as projects progress. There are opportunities for misunderstandings and mistakes, especially if one or other of those involved under-performs. Most consultants would accept liability for their own activities. In practice, their liability is much affected by the acts or omissions of others.

In former times, the practical consequences of interwoven responsibilities were less important. Projects were less complex with fewer specialisms, materials and components. More work was under the direct control of the main contractor who resolved much detail by good trade practice. There was greater collaboration, almost free of apprehension of litigation. PI insurance was then rarely called upon, if the former premium rates can be regarded as a good indicator.

More precise design methods lead to solutions that are inherently less robust. The general pursuit of value-for-money, often in terms of reduced fees and lower capital costs rather than with due regard to life cycle cost, can lead to lower standards and adversarial attitudes. Most contractors engage sub-contractors, who often rely on other sub-contractors or the self-employed. Control is fragmented, with little prospect of continuing relationships, and there is serious concern about the decline of operative skills.

No one factor is of decisive importance. Taken together, they make construction much more problematic and more dependent on searching investigations and detailed instructions. All

have brought risk management and defensive tactics to the fore and have encouraged risk shedding.

2.3 Perspective of Clients

The review identified three client groups:

- (a) Experienced clients with continuous construction programmes.
- (b) Less experienced and occasional clients.
- (c) Domestic clients.

Most major projects are undertaken for experienced clients. However, 25 per cent of new construction workload is accounted for by the less experienced and domestic clients. These groupings may be further sub-divided between the private and public sectors.

Many experienced clients are seen to be good clients who choose their consultants with care and operate as an integral part of the project team. Not all experienced clients are good clients. Some, by negligence or with intent, make as limited a contribution as possible to projects, sometimes to the extent of inadequate assessment, leading to many variations mid-stream, tight budgets and appointment of contractors of doubtful quality. When matters go awry, they are inclined to litigate rather than negotiate and may arrange matters so that they can walk away from projects unencumbered by liability.

Less experienced and occasional clients often share the objectives and priorities of experienced clients but are less able to prepare thorough briefs, select appropriate consultants, co-ordinate projects or manage a failure of services. Therefore, their consultants, effectively operating as project managers, have to shoulder many of the client's normal tasks.

The study drew very different responses about private and public sector clients. At best, there is little practical difference between these groups. At worst, private clients are overtly commercial and some attempt to transfer unreasonable risks to their consultants. Although the major public sector organisations administer their projects and tendering processes competently, the management of fee competition sometimes leaves a lot to be desired, with inexperienced consultants very much at risk. Also, as might be expected in so varied and large a group, basically sound policies can be interpreted negatively, with little willingness to take timely or unpalatable decisions.

Domestic clients are often unsure of their needs, have unrealistic expectations and are inclined to leap to litigation when these are not realised. In many cases, building and structural surveys are now so heavily qualified that they have lost much of their function in informing their clients. When demand is buoyant, some consultants refuse work for domestic clients, to avoid what they consider to be unnecessary and unrewarding risks.

Continuous clients of the industry gain both from their strength in the market place and from their experience in initiating projects and bringing them to fruition. Occasional and domestic clients cannot share the first benefit but they could be helped to share the latter, if the clients' guides that now exist were brought up-to-date and kept under review. A set of guides attuned to projects of varying size and complexity is needed, drafted to provide specific advice rather than generalities.

2.4 The Nature of Professional Services

The variety of services provided by the construction industry's professions is itself very wide, ranging from services that are essentially those of an applied mathematician or a materials scientist, to conceptual design overlaid with aesthetic values; from management to the quasi-legal role of arbitrators; from industrial relations to technical accountancy.

One important characteristic of the work of the construction professions is informed judgement. Most of the advisory and design roles entail assessing uncertainties; for example, the feasibility of a proposed development to be executed some years hence when all the factors justifying the investment may have changed; the settlement pattern of a project founded on variable strata; the weathering performance of tall buildings; or the efficiency and robustness of different ways of mobilising and managing construction resources. Informed judgement operates at many levels and not only for large, complex or innovative projects. A limited building survey or a house conversion, for example, calls for informed judgement if the opportunities and client's money are not to be misused.

The Institution of Civil Engineers states in its submission, "A professional person is paid for his opinions, not his doubts. The object should be to ensure that this can still apply and will continue to do so". Clearly the grounds for an opinion should be explained but without so emasculating that opinion as to make it valueless as the basis for the client's decision and action. Much the same applies when

designing and operating skills call for informed judgement. No matter how many options can be explored, decisions entail compromises and compromises necessarily entail risk.

To be effective, professionals must accept that some of their advice ultimately may be mistaken but, when justified, they must be prepared to stand their ground. Clients in turn must accept the possibility of mistakes and be prepared to accept unpalatable advice with good grace. Professionalism and trust march hand-in-hand—trust that a professional's comparative freedom to act will be exercised in the client's interest and not abused; trust that work will be done diligently, competently and carefully; trust that clients will stand by their briefs and decisions; trust that post hoc arguments will not be employed to create liability.

2.5 The Role of the Institutions and Trade Associations

Self-regulation imposes on the professional institution responsibility for ensuring the continuing competence of its members to practice. Until relatively recently, this responsibility was discharged by the institutions' role in devising examination syllabuses (which established the body of knowledge) and in examining aspiring members. Now that this task falls to the higher education sector, institutions monitor and validate courses and have the responsibility to ensure the continuing competence of practising members and, perhaps, the competence of offices offering services in their domain. These requirements might be met by obliging active professionals and consultancies to hold current practising certificates. The need for the institutions to discharge this responsibility effectively, visibly and transparently is further emphasised by this study.

Perhaps the most basic service that all the institutions perform is that of the learned society, principally through journals, conferences, lectures and seminars. These help members to be kept aware of changes in technology, practice and law. All institutions have expanded their services beyond this. As yet, none offers the full range of services that would be most helpful to its members.

Advisory services are increasingly considered to be an important part of an institution's function. These can play an important part in helping professionals both to improve their performance and to reduce their risks. Efforts to make the processes of dispute resolution less painful to all concerned are made through advisory services offered by some of the institutions.

Some of the key areas in which action is being taken but which should be developed further are:

- issuing good practice advice;
- promoting risk management, through good practice codes, participating in drawing up standard conditions of engagement and encouraging the use of QA;
- offering insurance advice and possibly insurance services;
- promoting mandatory continued professional development (CPD);
- issuing practice certificates.

The professional institutions currently exert a major influence on the scope and style of higher education. Experience, the interviews and the case studies confirm that professional services fail for a great variety of reasons, including a poor understanding of the physics and chemistry of construction, unfamiliarity with sound details and construction methods and less than effective management. For some years, many in higher education and the industry have argued that these wide-ranging subject areas could be best met by a substantial commonality between the education of the various construction professions, drawing on the continental European model. So far, only very limited steps have been taken. Some responding to the review held that joint education for the industry would remove some of the causes of misunderstandings and mistakes. They suggested that the syllabus requirements for the various professions should be reviewed to remove artificial barriers to joint education and that the arrangements for systematic CPD should be similarly reviewed.

2.6 Risk Management by Clients

2.6.1 Selection

Experienced private sector clients regard selection of consultants as one of the most important, if not the most important, of client functions. The crucial criteria employed are:

- prior experience of the consultant in projects of similar scale and complexity;
- adequate resourcing, wholly or mainly by the consultant's own staff;
- involvement of a partner or senior professional with authority;
- previous experience of working for the client (it follows that 'new blood' consultants are often broken in by being given smallish projects).

Experienced private sector clients typically draw on a small pool of consultants of proven ability. This procedure tends to promote greater efficiency and confidence. The client knows the consultant is capable and the consultant is aware of the client's needs and priorities and is motivated to perform well in order to win further commissions.

The chief difference in the public sector is that a much longer list of approved consultants is used and far greater use is made of fee competition rather than fee negotiation. This leads to a lack of continuity. Importantly, a design team that has demonstrated willingness and ability fully to meet a client's needs can rarely be directly rewarded with repeat work.

Selection is often a major problem for occasional and domestic clients, who are unlikely to be aware of the reputation of the professionals whom they select and uncertain as to whether they are suitable for the commission to which they have been appointed.

2.6.2 Appointments

Differences in the approach between the public and private sectors to appointments and conditions of engagement are marked by different attitudes to risk sharing and liability.

The public sector increasingly employs fee competition to select consultants. This apart, the sector accepts the management of risks and liabilities implied by the various standard forms of engagement, with the individual appointment of separate consultants but with a lead designer who is normally given responsibility for co-ordination. Hence the traditional allocation of risk and liability is not disturbed, even by the composite conditions of the Department of Health, which, with the improved arrangements for co-ordination, are of major significance for complex projects such as hospitals.

In the private sector, developers are trying increasingly to use conditions of engagement as a means to reduce their own risks in a project, by attempting to impose, for example, clauses requiring fitness-for-purpose or collateral warranties upon consultants. The consultants' perception is that they are very much the weaker party in these negotiations. Should demand falter, many may be forced to accept terms which will be difficult or impossible to fulfil. Conflict and litigation will surely follow.

2.6.3 Quality Management

Experienced clients achieve risk management by careful selection of the design team, thorough

briefing, appointment of experienced project managers, close monitoring of progress and a continuing relationship with preferred consultants. They consider it is better to have a successful project and somewhat curtailed litigation rights than a flawed project with all litigation rights secured. This tactic is open equally to less experienced clients. These simple measures go a long way to achieving the principal objects of certainty, risk management and avoidance of litigation.

In general, clients have not required formal quality management procedures from professionals. Few clients sought proof of their consultants' approach to risk management. Rather, these issues emerged during pre-qualification interviews or as a result of project managers having access to project teams. However, clients' attitudes may be changing: 90 per cent of those responding to the questionnaire asserted that they would prefer their consultants to be BS5750 registered, although they may not have seriously considered this as an option until asked the question.

Computer applications are well established in the construction industry but the great majority affect only one activity by one profession. More recent developments in information technology potentially enable many activities to operate from a common database. In principle, this should be much more efficient and eliminate errors arising, for example, from different activities being based on different versions of drawings. However, the transfer of electronic data between consultants, contractors and possibly clients is not without its problems of compatibility and data corruption. Issues of liability are likely to arise if the data transferred are asserted to contain errors which generate liabilities or costs or both. Also, in the short term, matters will be made more complex by the number of non-compatible Computer Aided Design (CAD) systems and by the variety of operating systems.

Originators of electronic data may well be under a legal duty of care towards others who may use the data they supply and they should make plain the exact character of their data format. Presumably, data users would be then responsible for verifying the compatibility of the data and of the data source with their system. Until there is further experience, prudent data generators should assume that they must be able to demonstrate that they have an effective system for data management. Indeed, this may be a high priority for QA in the construction industry. In the meantime, the Study Team notes the work in hand by the

Committee of NEDO's Construction Industry Sector Group which is examining 'CAD Data and Other Information Exchange in the Building Industry'. The issue is more fully examined at Appendix D2.

2.7 Risk Management by Professionals

2.7.1 Selection

The professions are deeply concerned that selection will soon amount to no more than a scramble in the market place. Fee negotiation is reluctantly accepted because it is part of a selection procedure which takes other factors into account such as skills, experience and track record, in addition to fees. Fee competition is much disliked, especially when the recommended procedures are ignored, for example when there is inadequate information upon which to bid, consultants in the tender list are not comparable and price is the only factor taken into consideration.

2.7.2 Conditions of Engagement

The questionnaire survey confirmed the dominant roles of the principal forms of engagement—the RIBA, RICS, ACE, PSA and local authority forms—with a not inconsiderable use of clients' own forms.

Current conditions of engagement were widely criticised as failing to:

- identify the class of service to be provided;
- identify and allocate inherent risks;
- make clear the role of insurance;
- identify the skills to be provided;
- take sufficient account of the realities of modern construction which may require the co-ordination of the designs and progress of many consultants and specialist suppliers;
- take sufficient account of the form of contract to be employed and of post-tender co-ordination; and
- avoid awkward gaps and ambiguities.

Responsibilities and liabilities must change if practice and processes change. Some of the more onerous impositions have no purpose other than to transfer risk from those better able to control it. The Department of Health has negotiated a composite set of conditions of engagement matched to its requirements. Sets of similarly well integrated and consistent conditions of engagement, not necessarily incorporating traditional attitudes to liability, could

establish models for appointment and risk allocation and provide a reliable basis for negotiation.

2.7.3 *Quality Management*

Consultants are currently experiencing a buoyant market, without enjoying a corresponding buoyancy in fee income, which has been depressed by fee negotiation and fee bidding. They are also very apprehensive of litigation. Together, these factors have led to a drive to improve efficiency, balanced by risk management. Typically, the action taken is to:

- codify procedures, for example by introducing formal arrangements for checking and occasional peer reviews;
- assess the benefits of applying to be registered as quality assured;
- carefully vet all conditions of engagement, including collateral warranties;
- transfer tasks and their liabilities to others, particularly contractors and specialist sub-contractors;
- retain experienced construction lawyers (or appoint them in-house); and
- ensure a practice's risks are properly reflected in the terms of its PI insurance policy.

Amongst consultants, there was no great immediate enthusiasm for elaborate risk management control systems. This is particularly so for the small partnerships where simple procedures are adequate. Clients' demands rather than conviction will lead to the adoption of formal QA but firms that have introduced it are well satisfied.

Consultants shared their clients' cautious approach to innovation. Some restricted the specification of untried materials or components by procedures such as having to consult the partner responsible for the practice's technical policy. The general impression is that innovation would be contemplated only when fees and the time in hand were sufficient for a thorough investigation. It follows that fees reduced by negotiation or by fee competition will curtail innovation, perhaps to the detriment of the long term competitiveness of the industry.

Designers have to respond to demands generated by regulations, by clients' needs and by developments in construction methods and materials. To this extent, the work of the industry corresponds to a continuous experiment which, if it were planned, could provide

feedback which would help the industry to improve its performance by learning from experience. In principle, the substance of some claims should provide feedback. This could alert practitioners to potentially hazardous design solutions or warn manufacturers of shortcomings in their products or point to the need for research. Moreover, were action taken, claims against insurance would fall. This has been the experience of the National House Building Council (NHBC). There would be advantage if the relatively few PI insurers devised a feedback system.

Consultants were concerned about the effects of clients' insistence on cost savings. Unduly tight budgets may force the selection of the second best, sometimes with disastrous results which may be laid at a consultant's door unless a client has been formally warned of the risk incurred⁽³⁾. Optimistic rather than cautious evaluation of site investigation, exposure or useage, for example, inevitably leads eventually to more failures. Conversely, lower design fees may encourage consultants to adopt fail-safe (but more costly) solutions because there are insufficient funds to explore options or to investigate potentially cost-saving innovations.

Finally, as with clients, not all consultants are good consultants. Lapses and mistakes are inevitable, although they may be reduced by quality management. Clients, consultants and experts agreed that over-reaching, whether of experience or resources, was often the cause of poor or erratic service. The tactics typically adopted by experienced clients and by their consultants are described at Annex D.

2.8 **Major Concerns of the Professions**

During the review, three factors were frequently mentioned as unreasonably increasing the liability of consultants.

2.8.1 *Loss of Control without a Corresponding Reduction in Liability*

Unlike the other participants, the principal construction professions often have a continuous involvement in a project from the feasibility study to the end of the contractual defects liability period. They are therefore vulnerable to claims arising from latent defects discovered perhaps many years after completion, whether the cause was an error of judgement, a lapse or mistake in design, faults in the work of a contractor or one of the many sub-contractors, or components or materials which failed to live up to expectation.

Under the current arrangements, for building especially, strategic decisions are made by

clients; project management is exercised by contractors, normally with little or no design responsibility; and execution and quality are largely the responsibility of sub-contractors, who may also have design and manufacturing responsibilities and liabilities. Roles, responsibilities and liabilities are interwoven.

Component construction illustrates the problem in an extreme form. Increasingly, components comprise the dominant cost of building projects. Some are complex, assembled from sub-components drawn from different sources, and involve a significant design input from specialist sub-contractors or component manufacturers. In the absence of comprehensive performance specifications, which are rare, specifications have to be devised so that the options can be appraised. Also, unless extensive testing and field trials are made, compliance with the specifications may not be capable of being verified. Such tests are accepted practice for major innovative projects, which command commensurate fees ⁽⁴⁾.

Good practice and diligence ought to be sufficient to counter negligence claims against the professional should components fail or not meet crucial aspects of their performance specification. It is less certain that a client's interest will be protected by the complex web of contractual relationships, guarantees and warranties which now characterise many building projects. This web may be illusory unless backed by insurance, fully maintained for six or ten years. If such arrangements are illusory, the consultants (or their PI insurers) are a prime target.

2.8.2 Collateral Warranties

The terms 'collateral warranty' or 'duty of care agreement' are loosely applied to contractual agreements between consultants or contractors and a third party, other than the client, who has an interest in the development. Commonly, the third party will be a funding institution, providing finance for the development, or a purchaser or tenant of the completed development. Such third parties would normally have no contractual relationship with the consultant or contractor.

Collateral warranties first appeared about three to four years ago, but the last two years have seen a very dramatic growth in their use, particularly in relation to commercial developments. That growth will inevitably continue. The structure of the full repairing lease, where the obligation to repair inherent defects in the building is imposed on the tenant, has been an important factor in promoting the demand for

warranties from tenants. The tenant is deprived of any recourse against the landlord under the lease and is left with an action in tort against the consultant or contractor. The opportunity to bring an action in tort has been restricted since the House of Lords' decision in *D & F Estates* (1988) and other decisions of the courts. These have had the result that the grounds for claims in tort have been very much circumscribed and the recovery of pure economic loss is generally very limited.

From a client's point of view, the consultant or contractor should not be relieved of liability simply because the developer is not himself occupying the building but is acting essentially as a project manager, with the building wholly funded by a financial institution or with a committed purchaser or tenant already established. Since collateral warranties are now invariably required by the funding institution and purchasers or tenants, developers are concerned that, if they do not insist on such warranties, the funding or marketing of the development will be prejudiced. Few developers will admit to seeking to transfer any greater rights to a third party than were already owed by the consultant to the developer under the normal terms of appointment. Undoubtedly, however, the effect of creating more than one plaintiff with equivalent contractual rights against the consultant is to immediately increase the consultant's liability.

Consultants' experience is that many warranties include unacceptable terms. Examples abound which seek to impose:

- professional liability beyond the conventional duty of care;
- contractual terms that do not feature in the agreement between client and consultant;
- warranties for the actions of other consultants, whether or not appointed at the time of signing the warranty;
- assignment to persons unknown at the time of signing the warranty, such as successive purchasers;
- assignment to tenants, especially when a project may have multiple tenants;
- provision for novation every time a property changes hands; and
- demands for insurance cover.

The problem is well illustrated by a quotation from the questionnaire survey:

"The developer client commonly requires contractual warranties to every third party with an interest in the development and, in the case of a retail shopping project, for example, such third parties could be very numerous. The commercial pressure on consultants to accept such a requirement is enormous. The form of warranty is one problem and again there are many sophisticated provisions which present a trap for the unwary. Provisions such as exclusive reliance by the tenant on the professional, with the professional's liability not to be affected by the tenant's independent review or any act or omission of any third party, reinforce the assumption that the professional's indemnity cover provides insurance for the building come what may and that the developer's role is of no relevance. The availability of insurance for risks arising under warranties is a more serious problem, with many insurers reserving their position and likely to seek to repudiate liability when a claim arises. Professionals have no certainty in signing warranties that risks arising under such warranties will be covered. This is an unprecedented situation. The professional who is covered when a claim is made will pick up greater liabilities in circumstances where the rest of the design team may not be covered. Furthermore, these warranties are required from professionals, possibly from the management or main contractor, but rarely from the sub-contractors who carry out design work (with the exception of engineering services). Thus the professional will again be isolated in terms of liability when facing claims arising under warranties and will be unable to pass liabilities back to a third party, because that third party will not have a liability in contract and may not have a liability in tort."

In many cases, the attendant liability extends the liability normally covered by PI insurers. Moreover, collateral warranties are frequently sought as a project approaches completion and the developer discovers that a potential purchaser or tenant demands this protection before making a deal.

Collateral warranties are one of the most serious concerns facing consultants who are involved in commercial development. Such warranties involve the creation of a new range of contractual liabilities owed to third parties who often have no involvement in the construction process or in any of the decisions about quality or performance which have been a part of that process. The diversity of the contractual warranties required of professionals and the ambivalent attitude of the insurance market

towards cover for such warranties are very worrying features. Although the full implications of collateral warranties have not yet been appreciated, it is clear that they will have a very substantial impact in the long term on professionals' liability.

2.8.3 *Inspection and Supervision*

Claims often allege negligent inspection or supervision. Many consultants are now unwilling to do more than the periodic inspection needed to ensure that their design intentions are being basically realised and that the standard of workmanship accords generally with the specification. Despite this, the courts appear sometimes to judge the outcome of a claim alleging negligent supervision as if intensive inspection had been part of the consultant's appointment. This uncertainty would be removed if tender documents required contractors to state the quality management regime which they propose to implement. The lead consultant could then verify that a contractor's quality management regime had been implemented and that the records maintained confirmed compliance with the specified standards. Liability for supervision would, therefore, be entirely the contractor's responsibility and in such cases professionals ought not to be joined in workmanship actions.

When this procedure cannot be followed or is unsatisfactory to a client, consultants should be given a separate appointment for a more intensive level of inspection at an agreed level, as is the case with major engineering projects. Clearly, different liabilities would flow from such appointments.

2.9 The Study Team's Assessment

Construction is characterised by the interdependence of roles, responsibilities and liabilities. This is especially so in building and is made worse by the current trends leading to greater interdependence. The Study Team concluded that:

- apart from a reluctance to serve domestic clients if others are available and for building surveys to be very heavily qualified, the services of construction professionals have not been withheld as a result of liability considerations;
- experienced clients with continuous construction programmes effectively create a sub-set of the industry, employing a pool of consultants and contractors of proven experience. This continuity of experience solves many of the industry's problems of co-ordination and interdependence;

- these experienced clients are heavily committed to their projects and devote resources to ensure their success;
- many less experienced clients fail to fulfil their proper role and seek to transfer risks to others so that they can walk away from projects unencumbered;
- spurred on by reduced fees on the one hand and by apprehension of litigation on the other, many consultants are codifying their arrangements for quality management and are adopting defensive tactics to limit their liability;
- consultants, especially in small firms, are reluctant to adopt formal quality assurance procedures such as BS 5750. Most rely upon the good design practice which they have developed over many years;
- larger practices now devote much effort to negotiating realistic conditions of service, some by having in-house legal sections. The less wary have almost certainly accepted risks which they cannot control and liabilities which they may regret;
- fee competition too often ignores good practice rules, which may result in consultants being appointed without being fully aware of their liabilities;
- many clients are moving away from standard conditions of engagement and are seeking to impose more onerous conditions which may be impossible to fulfil. Collateral warranties, which greatly extend a consultant's liabilities, are very widely required, often as a condition of the appointment;
- large and complex or innovative projects, adequately financed for proper investigations, appear to pose few problems of professional liability, perhaps precisely because they are large and complex or innovative; and
- mistakes and lapses occur. Consultants are unwise to engage in projects well beyond their previous experience unless great care is exercised.

References

- (1) *D & F Estates Ltd and Others v. The Church Commissioners for England* (1988) 3 WLR 368.
- (2) Manual of the British Property Federation System 1983.
- (3) *Richard Roberts Holdings Ltd v. Douglas Smith Stimpson Partnership and Erosion and Corrosion Control Limited* Official Referees Business before His Honour Judge John Newey QC 27 October 1988.
- (4) "The Structure of the New Headquarters of the Hong Kong and Shanghai Banking Corporation in Hong Kong", Jack Zunz, Mike Glover and A. Fitzpatrick, in *Structural Engineer*, Vol 63A, No9 (1985), also the *Arup Journals* Vol 17, No.4 (1982) and Vol 20, NQ.4 (1985).

SECTION 3

Standard and Reliability of Professional Services

3.1 Foreword

All the institutions' responses accepted that clients have the right to expect that their chosen professionals will perform their services with diligence and care. Professionals must expect demands for redress when the agreed standard of service is not performed. There were reservations about the unpredictability of construction, the costs to clients of over-design and the ease with which errors may be accidentally or deliberately concealed during construction.

3.2 Non-Project Services

Providing clients accept that services involving the interpretation of incomplete information amount to informed judgement, the liability problems arising from non-project professional services are manageable. What must be stated explicitly is the basis of the informed judgement, avoiding both unsubstantiated statements and over-qualified, anaemic reports.

Clients value feasibility studies and place great reliance on them when making investment decisions. Such studies are seen by consultants as exciting, challenging and truly professional tasks. Because time is often short, they may be commissioned by a hasty conversation rather than by a thought-through brief. Lack of precision at the outset is a fruitful ground for subsequent dispute. If the outcome confirms the client's expectations, all is well. If not, a client may look to a professional for redress, especially if that professional is known to have a high level of PI insurance cover. In practice, a professional's advice will be only one amongst several factors which clients take into consideration before making an investment decision. Also, the outcome will often be determined by external factors, for example the state of the market when a project is completed. Nevertheless, as clients seek to recoup their losses, the speculative nature of the feasibility study may be forgotten. A very substantial claim may be launched, even though the fee was modest.

In the opinion of the institutions, building surveys and structural surveys generate more

claims than are justified. This reflects the hazardous character of surveys. Often, it is impossible to diagnose potential faults without dismantling part of the building being surveyed. Few clients are prepared to pay for a full survey which may entail moving furniture, opening up floors and affording access to roofs. As a result, a report is based partly on observation and partly on informed judgement. And informed judgement can be wrong. The 'reliance' argument accepted in *Yianni*⁽¹⁾ has caused consternation. Since then, surveyors have adopted heavily defensive tactics, which greatly reduce the value of their reports, and have attempted to limit their liability by disclaimers. Depending on the circumstances, such disclaimers may not withstand challenge under the Unfair Contract Terms Act (1977). A recent decision of the House of Lords in *Smith v Bush*⁽²⁾ has made it clear that such disclaimers are ineffective where claims in tort are brought by domestic clients.

It was also held that surveyors are put at great disadvantage when plaintiffs are assisted by Legal Aid. The most cost-effective tactic in such circumstances is to surrender. This issue is considered fully in the report of the study examining the liabilities of non-construction surveyors.

Surveys commissioned by knowledgeable and experienced clients generate few problems. Such clients recognise and accept that it is impractical to dismantle every dubious feature. In contrast, the expectations of occasional and domestic clients are often unreasonable and trigger claims. Surveyors interviewed had devised lexicons of highly qualified phrases for all common building features. Reports culled from these were accepted as being much less useful since they do not clearly indicate whether a building would be a risk worth taking and what would be the approximate cost of immediate non-cosmetic repairs.

3.3 Project-Related Services

Clients responding to the review were usually satisfied with the quality and reliability of

professional services which they received. Mainstream activities attract the majority of claims, as might be expected. Alleged faults are seldom associated with innovation. Case studies made available to the Study Team confirmed this impression. This is unexpected, given the institutions' emphasis on the risks of innovation. In the cases reported, design faults are usually elementary; for example, building on sites subject to soil heave, taking inadequate precautions when coping with a high water table, making errors in detailing and so on. Clearly, some consultants do not satisfy the criterion of an ordinary skilled person exercising and professing his or her special professional skills. This emphasises the importance of improved quality management.

Some clients interviewed had severe lapses of services to report. The majority interviewed were either satisfied or highly satisfied with the quality and reliability of professional services, reinforcing the impression of the questionnaire survey. The following points were made:

- the design flair of architects and their ability to devise satisfactory planning solutions were praised;
- structural design and other civil engineering services were judged as competent;
- the initial performance and liability of mechanical engineering services were widely criticised. The complexity of these systems and their continuing need for correct operation and maintenance may demand a higher price than clients have been willing to pay; and
- building surveying and quantity surveying services were seen as reliable and competent; building surveys (a more accurate description than structural surveys) are a special case.

There were three general criticisms of professional services:

- design co-ordination and co-ordination of post-contract design were held to be pervasive weaknesses, especially in major projects. Poor co-ordination often leads to hurried redesign and thus to delay and mistakes;
- there are too many relatively minor but irritating faults which emerge shortly after hand-over; and
- the professions, with the notable exception of quantity surveyors, do not always adopt their clients' priorities as their priorities. This comment usually referred to the two factors essential to

commercial viability—control of costs and completion on time.

What was not expected was that clients' satisfaction with the finished building was less than that for professional services in general. The completed project encompasses the work of all involved, including that of the client. Work is interdependent, so that flawed performance by one participant can compromise the efforts of others. The strength of the chain is that of the weakest link and a client's abiding impression may be dominated by memories of delayed completion, recurrent water penetration, failed screeds or troublesome air-conditioning. Temporary coalitions of all the parties mobilised to tackle a construction project do not have the advantages of controlled environments and repeated experience, which characterise manufacturing. The disadvantages of the inevitable discontinuities and short-lived involvements can be countered only by consistent standards and by unremitting vigilance.

3.4 The Study Team's Assessment

The Team concluded that:

- there are numerous examples of failed professional services, some arising from lapses, some from mistakes and some from incompetence. However, when set against the vast scale of the industry, the level of performance is satisfactory if not always perfect;
- the questionnaire survey confirmed that most clients were at least satisfied with the standard of professional services;
- innovative projects, on the evidence presented, are no more prone to failure than traditional construction. However, innovation is normally associated with large projects where failure can be extensive and costly;
- clients emphasise, as matters for concern, failure to identify with their operational goals, poor co-ordination and inadequate mechanical engineering services, particularly air conditioning; and
- good projects start with good clients commissioning competent and sufficiently experienced consultants. Recent emphasis on systematic quality management and quality assured products and procedures should materially improve performance.

References

- (1) *Yianni v Edwin Evans and Sons* (1982) IQB 438.
- (2) *Smith (AP) v Eric S Bush* House of Lords Judgement 24 April 1989.

Professional Indemnity Insurance

4.1 Foreword

PI insurance indemnifies professionals for claims made against them for their negligent actions or omissions committed in the course of the provision of their services. The background is fully described at Annex A. The principal features are:

- unlike most other classes of insurance, PI insurance is placed on a claims made basis; the indemnity relates to claims or potential claims against the professional notified during the period of insurance, irrespective of when the alleged negligent act or omission occurred;
- premiums are substantial, often representing a practice's largest overhead; and
- PI insurance protects the interests of the insured, not those of the client or of other third parties.

This section examines the comments and principal criticisms of professionals, their clients, the institutions and the insurance sector in relation to PI insurance.

4.2 Affordability

Premiums are said to be unaffordable by many practices unless onerous terms, for example restricted cover and large deductibles, are accepted. The interview survey confirmed that consultants rank PI premiums amongst the most costly of their unavoidable overheads, amounting on average to an 11 per cent surcharge on technical and professional labour costs. Partnerships have been hard pressed at times to fund their premiums, especially when there has been a surge in fees earned in the immediately preceding years. It has been estimated that a substantial proportion of architectural practices with fewer than five staff are currently uninsured.

PI insurance premiums assume a new significance with the increasing incidence of fee negotiation and fee competition. As fee income is reduced, fixed costs become ever more burdensome. Labour costs can be trimmed by

improved efficiency and by reducing the service, for example by investigating fewer options. Premiums are based on an assessment of the risk of a consultant's portfolio of past projects and current activities. They will therefore become an even higher proportion of fee income as this income is reduced in relation to workload.

4.3 Premiums

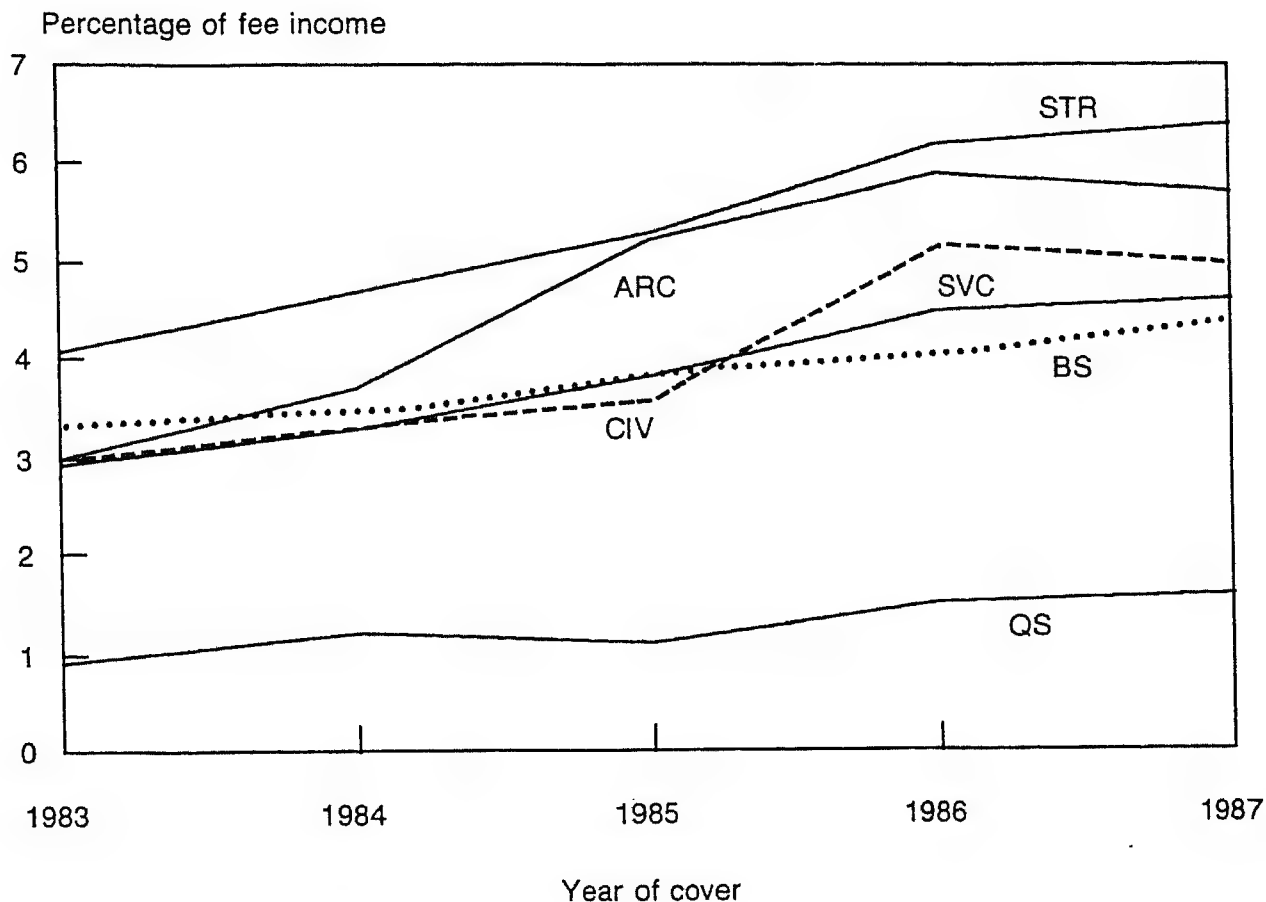
The successive increases in PI insurance premiums from 1985 to 1987 are resented and poorly understood, especially when they are contrasted with the claims experience of individual consultants. Some consultants, with virtually a clear claims record, have had to meet swingeing premium increases, despite accepting very much higher deductibles. Increases of 250 per cent were mentioned, without any change in consultants' circumstances. The objections are now less vociferous as rates have stabilised or even reduced.

Many factors affect the general level of premium rates. They include the nature of the market, insurers experience of the class of risk and the circumstances of the insured. PI insurance has displayed a cyclical history, due, at least in part, to the very few insurers engaging in this class of business and the disturbance that occurs when an existing insurer leaves the group or new ones join. The years 1985 and 1986 were periods of steep increases; 1987 was more stable. Some premium rates reduced in 1988, as more capacity became available, and this situation has continued into 1989. The data obtained from the survey of professionals (shown in Figure 4.1) demonstrate these trends.

The average rates conceal, however, a wide variation in the rates paid. This leads to considerable discontent among consultants, particularly those who have never made a claim against their insurers. Many expressed the view that they receive insufficient credit for their superior performance. However, claims do arise against practices which have never previously suffered a claim and it is this risk that they are insuring. For example, one major practice with no claim for 20 years or more was

Fig. 4.1 Insurance Premiums

by discipline



one of the several defendants in litigation which cost the insurer in excess of £10m. All practices are, of course, subject to general increases when it is necessary for premiums for a particular discipline to be raised, but increases for practices with a good record are likely to be far below those applied to consultants with a poor claims history. The premiums of the many pay the claims of the few; it is not possible to fund increasing levels of claims by increasing the premiums of claim-bearing policies alone.

The following procedure is typical of insurance companies when establishing an individual premium. Firstly, a standard set of premiums for a standard level of indemnity and deductible is established for the various disciplines. Typically, these are about five per cent of the design fees for architects and civil and services engineers and of the notional design fees for contractors offering design and construct services, rather more for structural engineers and much less, one per cent perhaps, for quantity surveyors. These rates are then modified by many factors, for example:

- size of practice;
- deductible;
- limit of indemnity;
- risk relating to past work;
- type of operations;

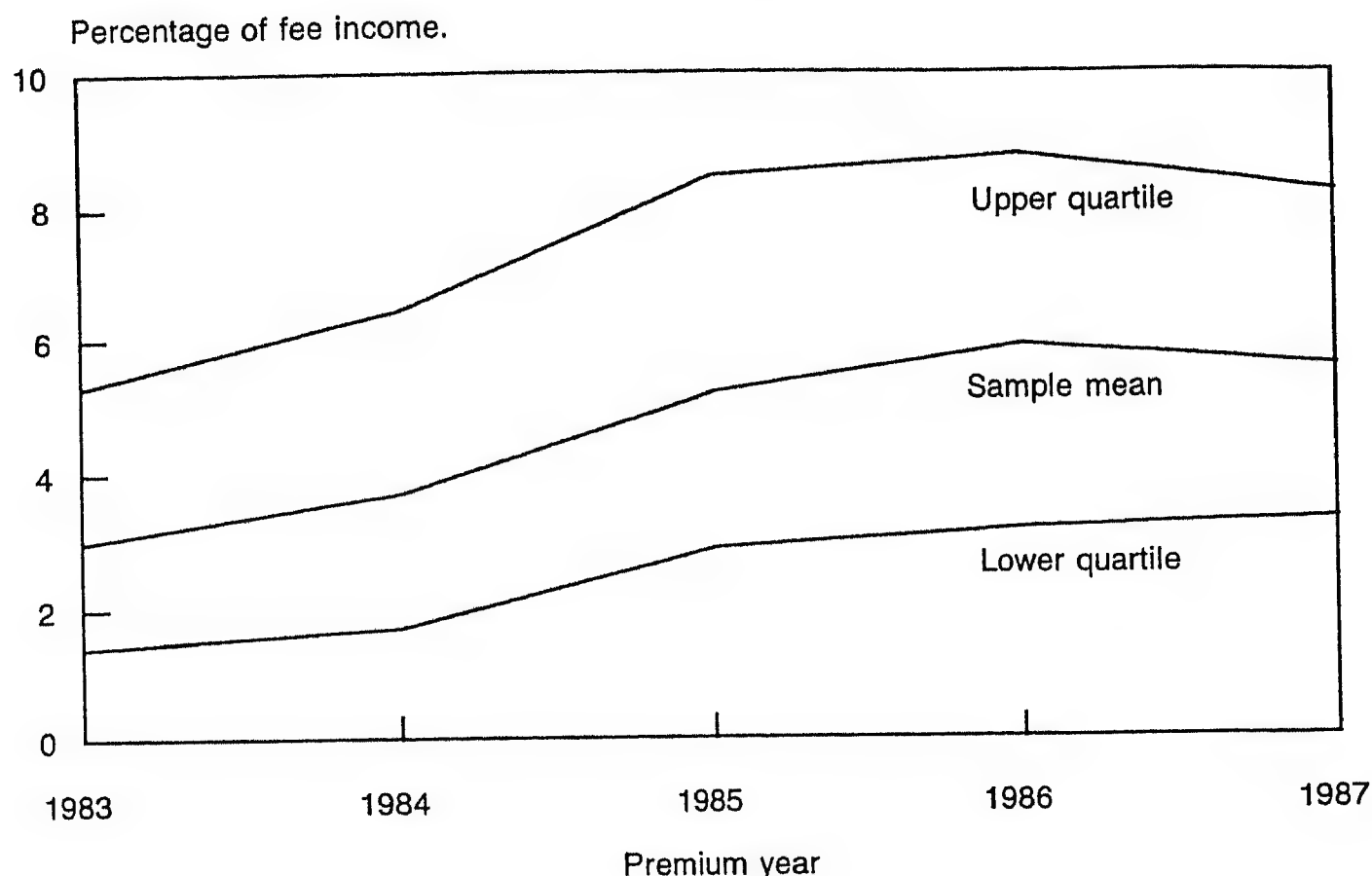
- territorial spread of risk;
- assessed quality of practice;
- previous claims record; and
- policy wording which restricts or extends liability.

With all these variables in play, it is to be expected that premium rates are very variable. Those reported ranged from 0.25 per cent to over 20 per cent of fee income. Figure 4.2 depicts the mean, lower and upper quartiles of premium rates in 1987 for architects responding to the survey.

Two important factors in determining premiums are the limits of indemnity and the deductible. Both have increased sharply during the past decade. The levels of indemnity and deductible may be subject to a minimum or maximum in relation to fee income, and the calculated premium itself may be subject to limits either absolutely or in proportion to fees. In principle, there is no limit to the liability of a professional practice for the consequences of its negligence. However, all PI insurance contracts specify a limit to the indemnity provided for the period of the insurance.

The choice of the limit of indemnity sought is made by the individual practice in consultation with its broker and will have regard to the volume and nature of work undertaken and the

Fig 4.2 Spread of Insurance Premiums
for Architects



cost of the premium. From the survey of professionals, it is evident that limits of indemnity vary widely, although large practices usually have higher limits than smaller ones. Figure 4.3 shows the average limits of indemnity for different sizes of practice obtained from the survey of professionals. It is clear that smaller practices may not have cover adequate to meet the potential claims for their negligence. They rely upon the belief that clients will not pursue them for sums beyond the limit of their insurance. In fact, the personal assets of partners may be substantial and are also at risk if a claim exceeds the limit of indemnity.

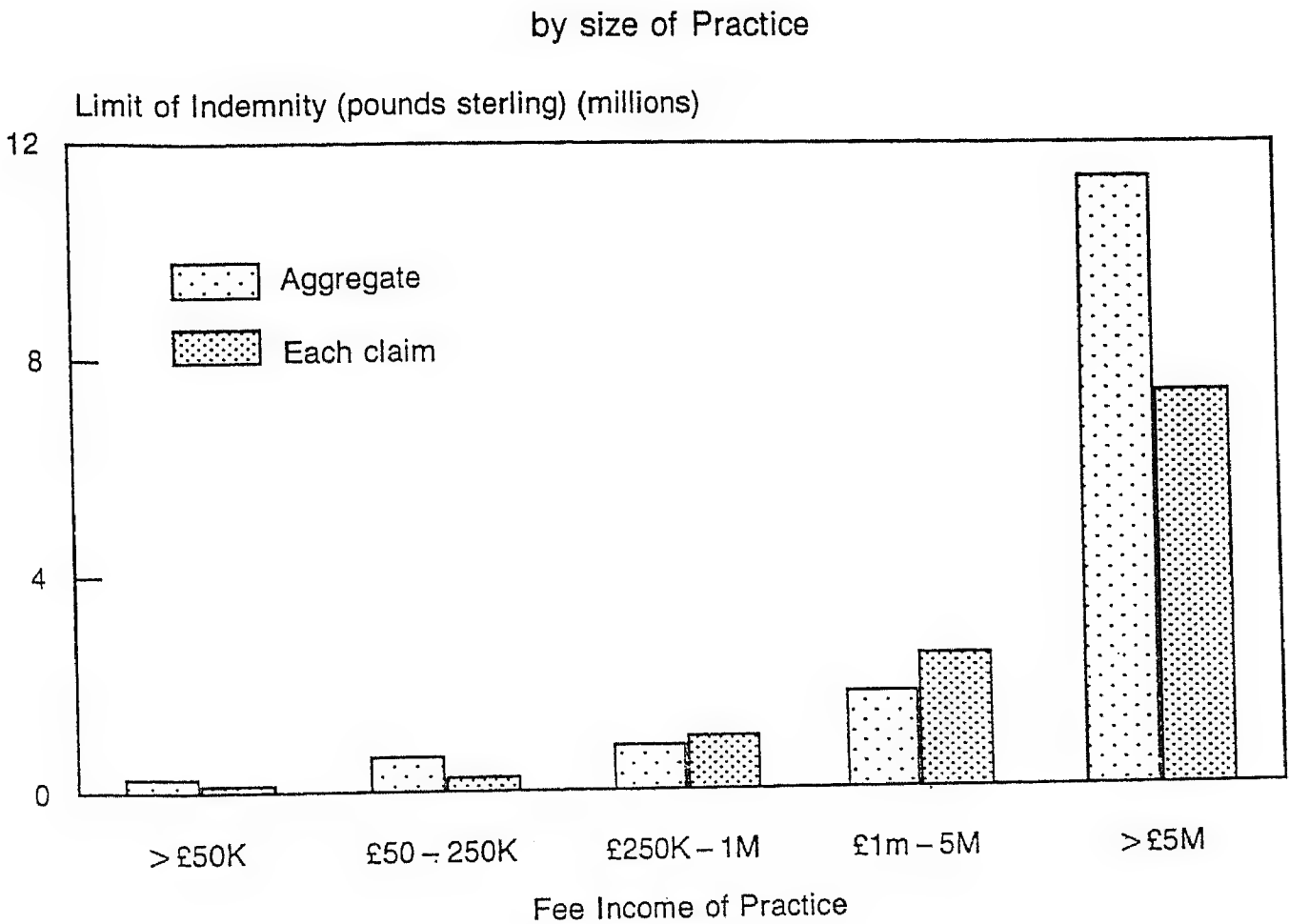
Insurers always require the insured to carry part of the risk themselves by means of a deductible, usually expressed as a fixed sum to be deducted from each and every claim. The function of the deductible is twofold. Firstly, it considerably reduces the insurers' administrative costs in dealing with small claims and, secondly, it is seen as an incentive to the professional to minimise risks. Levels of deductible vary considerably but are typically about one to two per cent of the fee income subject to a minimum sum for very small practices. Many practices will accept a larger deductible than the minimum required by their insurers, usually referred to as a voluntary deductible, in order to reduce premiums and to give greater scope for negotiated settlements. Partly driven by clients' insistence on high levels of insurance

cover, deductibles have increased fivefold from 1983 to 1986, with larger practices often accepting deductibles well in excess of £100,000.

This greatly increases a practice's risks. Because of large deductibles, practices already meet the cost of most claims and are still liable should a large claim exceed the limit of cover. When more than one claim from totally unrelated causes arises on a project, for example a leaking roof and defective air conditioning, the insurer is entitled to apply the deductible separately to each unrelated claim. This definition is favourable to the policyholder if one act of neglect, error or omission causes loss to a number of different claimants. For example, a leaking roof may affect several tenants, each of whom makes a separate claim against the insured. Conversely, a consultant who had opted for a very large deductible could be struck down by a call to contribute to several distinct claims arising on a major project. This has led to one consultant having to pay more than £1m towards a settlement.

Some respondents argued that PI insurance has the effect of reducing competitiveness, in that large consultancies pay lower premiums, expressed as a percentage of fee income, than smaller up-and-coming consultancies. The review confirmed that premium rates are related to size but with medium-sized practices

Fig 4.3 Limits of Indemnity in 1987



paying higher rates than those of very small and very large practices. This is demonstrated at Figure 4.4.

4.4 Level of Service

There were many comments about the level of service, particularly as regards the capacity of the insurance market, brokers' services, support during litigation and the problems of retired partners.

Unless there are particularly onerous features, currently (April 1989) cover up to £30m or more is available without difficulty. Owing to the cyclical nature of the PI insurance market, these high limits cannot be assured in the future. While cover in excess of £5m is at present available at reasonable cost, the higher levels of the limit of indemnity are likely to become proportionately more costly if the market hardens and there is a squeeze on capacity.

With isolated exceptions, the consultants interviewed were complimentary about their insurers' support in litigation. In different ways, swift and commercially sensible settlements were often facilitated. Clearly, there were advantages when the insured, the broker and the insurers had worked together for some time. In practice, insurers appeared to respond flexibly to situations in these cases. Smaller consultants have less clout but generally appeared to be no less well served. From the

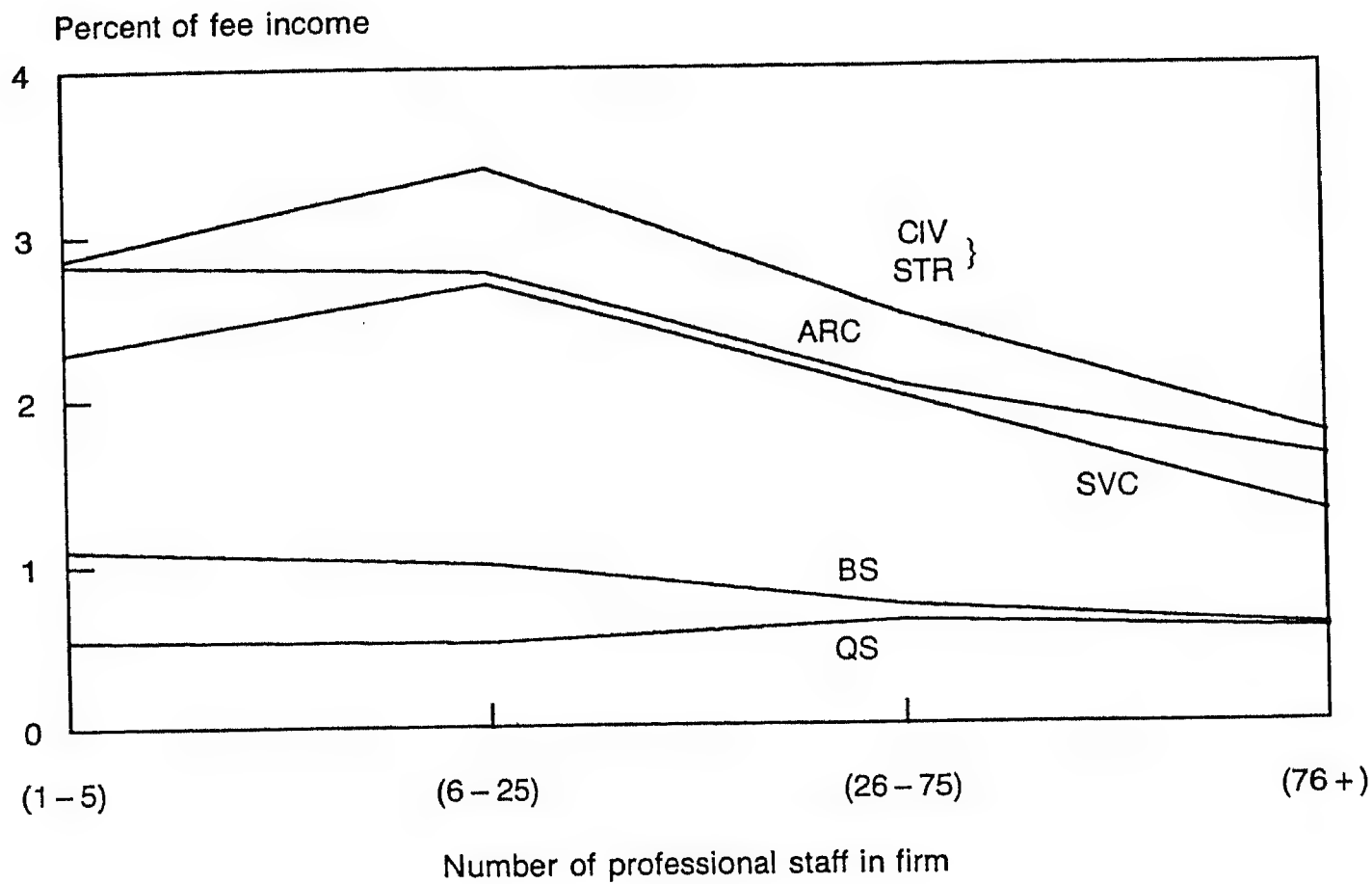
insurers' standpoint, there is the choice between rushing to a negotiated settlement, which must be in their best interest for small claims, and defending the reputation of the insured. The evidence of the review is that a reasonable compromise is struck.

During the enquiry, it became evident that some consultants are much less well informed about the principles of PI insurance—and possibly other insurance—than might be expected given its importance in safeguarding their interests. Some of those interviewed had been surprised when, for example, insurers required two or more deductibles to meet claims arising from one project. There would be advantage for all concerned if PI insurers, together with leading brokers and knowledgeable consultants, produced and kept up to date a code of practice for PI insurance.

Contractors offering professional services asserted that they were much less well placed than consultants. The few insurers willing to underwrite their risks are particularly wary of any contractor offering these services for the first time. PI insurance is especially costly to contractors who undertake design and construct services only intermittently. Contractors also argued that the professional liability of clients' consultants, contractors' designers and any consultants employed by the contractors are uncertain and that there may be serious gaps in

Fig. 4.4 Insurance Premiums

Variations by size of practice



PI insurance cover. Despite the contractors' fears, the evidence from insurers does not suggest that the cost of contractors' PI insurance is higher than that of consultants offering similar services.

4.5 Value for Money

The professions do not accept current premium levels as reasonable. Of those responding to the questionnaire, 70 per cent did not regard the cost as reasonable and 74 per cent felt they did not get value for money from PI insurance. Clients also state that they do not get value for money from the premiums they pay indirectly through fees.

Much has been written about the efficiency of PI insurance and the proportion of premiums paid in settlement of claims. The insurers were reluctant to provide information. However, several independent sources report that about one third of the premium income is actually paid to those who have suffered loss. The survey of insurers shows that 30-40 per cent of premium income is consumed in legal and expert witnesses' costs. The inference is, therefore, that the remainder, again roughly a third, represents administration costs and profit for the insurer and broker. It should be emphasised, however, that a proportion of the brokers' and insurers' costs is that incurred in advising their insured on risk management and also in successful defence of claims against

the insured. An insurer undertakes to indemnify the insured against proven professional liability and part of this commitment is to defend the insured. Insurers are not liable to pay on demand.

It is also asserted by some that insurers make excess profits because there is insufficient competition between PI insurers. Were PI insurance very profitable, other insurers would enter the market: there is no barrier to entry. The study could not assess profitability, which must be critically affected by the chance occurrence of very large settlements or awards and by the success or otherwise of an insurer's investments. Data provided by two insurers, comparing the amounts disbursed in claims, fees (legal costs of the insured) and reserves, do not suggest that PI insurance is exceptionally profitable when account is taken of insurers' administrative costs. Reserves for unsettled claims remain a critical factor in the profitability equation for many years, due to the inevitable delay in the final settlement of most claims.

From a consultant's standpoint, PI insurance has the inevitable characteristic of all insurance, namely that cost effectiveness can be assessed only in aggregate terms. This in no way lessens the value of PI insurance to consultants, few of whom would be able to absorb the cost of major litigation leading to a court hearing, quite apart from the risk of heavy damages and costs

awarded by the courts. PI insurance provides the security necessary to practice in an uncertain world.

Value for money from a client's standpoint is another matter. Rough checks with a few major clients with long term continuous construction programmes showed that the monies recovered are small, very small in most instances, in comparison with the imputed PI premiums paid via professional fees. This is to be expected because premium income has to provide for commission, reserves, administration costs and legal and expert fees, as well as any disbursements to plaintiffs. Of course, as with all insurance, the cost effectiveness of PI insurance for any client would be dramatically changed by an award of major damages.

4.6 Possibilities for Reforming Insurance

Some interviewees believed that clients' insistence on high levels of PI insurance cover had become too costly, especially when each consultant engaged for a project is expected to insure for, perhaps, £5m for each and every claim. They thought that insurance arrangements should be radically reformed. Four possibilities were mooted:

- *Specified levels of normal cover*

An industry-wide convention, which would specify levels of PI insurance cover appropriate for different disciplines and different consultant sizes, was given limited support. Clients wishing to have PI insurance cover at a higher level would pay for the additional cover. Quite apart from clients' reactions, which are unlikely to be enthusiastic, there are practical problems, mostly concerned with the administrative task of ensuring that clients continue to pay for the top-up premium for, perhaps, 15 years after completion. This would be formidably difficult if, as is likely, insurers change from time to time or the building is sold.

- *Project based PI insurance*

A wider use of project-based PI insurance was advocated on the basis that a single insurance for all the professions would avoid multiple joining and separate representation for each consultancy joined in an action. Of course, this united front may make successful claims less likely. Apart from massive projects where such insurance is available at a price, the proposal was thought to have too many practical difficulties, including those of ensuring that annual premiums

are extracted from, say, six to ten consultants for fifteen years after completion, and of dealing with the consequences should consultants merge or go out of business. Most insurers will not write PI insurance on other than an annual basis; any move towards long term policies would drastically reduce available capacity. Contractors' experience overseas underlined the practical difficulties of this type of insurance which, in any case, would not mesh easily with contractors' general insurances.

Despite these problems, a Lloyds Syndicate has recently launched a project insurance policy, which is designed to protect the developer, contractor or project manager against claims arising out of the professional negligence of all the professionals engaged on a contract. This policy will provide an aggregate excess which can be eroded only by claims which exceed the standard policy deductible. Risks will be considered for periods of up to six years, with limits of indemnity up to £10m, and can be arranged in a number of formats depending upon price requirements. The policy is not available for projects undertaken in the USA or Canada.

- *Building Users Insurance Against Latent Defects*

Nearly all the institutions argued for the adoption of the proposal in the report, 'Building Users Insurance Against Latent Defects (BUILD)'⁽¹⁾, which recommends that clients should insure risks which they cannot afford to carry against material damage. Were BUILD in place, PI insurance would continue its current role of protecting professionals against their insured liability, except that two of the most potentially costly and contentious categories of claims would be met by clients' insurance, ideally with the material damage insurers waiving their subrogation rights against the consultants and contractors. In this way, clients would be assured of being indemnified for the cost of structural and weathershield failures, without need to prove negligence or omission. Concern has been expressed by those responsible for the design of elements not covered by BUILD—in particular, engineering services—that they would find themselves isolated from those who are covered and there-

fore be more exposed to claims of negligence.

— *Protection of retired partners*

The adoption of better arrangements to protect retired partners who are not otherwise indemnified by the current PI insurance policies of their former firms was strongly supported by the institutions and consultants' associations. Most now insure their 'run-off' risk year by year, albeit on a reducing premium basis, and the annual premium payable after retirement cannot be offset against tax. Cover for a five year period is now available for surveyors on payment of a single premium. The insurers' intention is to offer further run-off cover when the initial five year period expires. This will depend on the willingness of the insurance market at that time to continue the cover. Engineers insured with the Association of Consulting Engineers' scheme are able to purchase a six year run-off policy for a single premium. Insurers are examining the possibility of offering other professionals run-off cover for a period of years for a single premium.

4.7 The Study Team's Assessment

The Team explored the criticisms of PI insurance and its assessment is as follows:

- the purpose of PI insurance is to safeguard the insured, not their clients or third parties;
- there is, therefore, no cause to criticise insurers for the proportion of premium income expended in litigation;
- variations in premium rates are partly cyclical, falling and rising as insurers and re-insurers enter and leave a specialised market;
- at any time, insurance premiums take account of many factors resulting in very variable premium rates for consultants in the same profession, which may explain the very different attitudes to PI insurance;
- more affordable 'run-off' protection for retired partners is justified and should be a high priority;
- although in a large industry there will be lapses, normally insurers adequately support the insured in defending claims. Brokers' services are improving, perhaps in response to competition;

- from the consultants' standpoint, PI insurance is a necessary expense. It is value for money if the industry as a whole reduces claims and litigation to a minimum by effective risk management;
- from the data available, insurers do not make monopoly profits; and
- from a client's standpoint, PI insurance is a very indirect way of protecting their interests. Project-based PI insurance would have advantages but runs against the grain of PI insurance practice. Material damage insurance is a direct safeguard against latent defects and is commended.

The Team concluded that:

- PI insurance is currently a heavy burden on the professional. There is every reason to believe it will become even more costly when the PI insurance market hardens again, especially if litigation increases and fees reduce as a result of fee negotiation and fee competition. These additional costs will be passed on to clients;
- currently, capacity is sufficient. However, should the incidence of costly awards and settlements increase—a strong possibility if nothing is done—and insurers and re-insurers withdraw, capacity could be restricted or high levels of cover become prohibitively costly; and
- some consultants are not sufficiently aware of the care needed when negotiating insurance terms to ensure that these reflect a practice's needs—for example, the impact of several calls for the deductible for each different claim arising from one project. A Code of Practice is needed.

References

- (1) NEDO 'BUILD' report (1988).

The Law and Law Reform

5.1 Foreword

At the invitation of the Study Team, Professors Phillip Capper and John Uff of the Centre for Construction and Project Management prepared a substantial report, 'Professional Liability in the Construction Industry' ⁽¹⁾. Although dated as recently as April 1988, some sections of the report have been overtaken by recent decisions of the courts, especially by the Lords' ruling on the *D & F Estates v Church Commissioners* appeal. Because of this, the Capper/Uff report has been summarised and revised by Professor Capper and is at Annex B.

For the most part, arguments for law reform have to be based on an assessment of informed opinion. Quantification is virtually impossible, accessible records do not exist and the consequences of law reform are difficult to assess. The industry's activities are very diverse and the reactions of individuals to new legal constraints and opportunities are unpredictable. To quote Phillip Capper ⁽²⁾ —

"Just as tortious negligence was the fertile breeding ground of building litigation in the 1970s and 1980s, so legal imagination and innovation will now be applied afresh to such contractual devices as short-cuts in the usual chain of contractual responsibilities in designing, building, selling and letting of buildings. Duty of care deeds, warranty letters, assignments and novations are the new order".

In this section, the way in which the law has developed and the concerns of the professions and institutions are analysed. Many proposals involving changes to the law were put to the Study Team; these are summarised in the divisions into which they naturally fall. The discussion and proposals for change exclude actions arising from death or personal injury.

5.2 Legal Background to Professional Liability

Before the early 1970s, most of the difficulties which now arise from professional liability either did not exist or were of manageable proportions. Actions in tort were rare, there

was no tradition of multi-party claims, no particular difficulty in finding or affording PI insurance and no apparent or pressing need for limitation of liability. It appears that few professional firms had any direct experience of litigation or arbitration beyond that arising from contractors' claims.

The period from the mid-1970s until the mid-1980s saw a consistent progression of decisions in which the courts were willing to extend the availability of tortious claims where none had previously been thought possible. The result was an almost complete reversal of the previously established principles which coincided with, and was arguably fuelled by, a significant growth in the volume of defects being found in recently completed developments and an increasing readiness on the part of building owners or occupiers to seek legal redress. Consequently, there was an increase in the volume of litigation, in terms of the number of actions, the number of parties involved and of length, complexity and cost. Most professional firms of any size have now experienced litigation and practitioners are becoming used to firms appearing in one case as an expert witness and in the next as a defendant.

The main explanation for this development is that the context in which the courts abandoned *caveat emptor* in relation to buildings involved an eminently suitable target for proceeding to litigation; local building control authorities did not disappear or become insolvent. In the mid-1980s, the courts began to adopt a new policy of caution, tending to restrict local authorities' liability to imminent threats to the health or safety of the occupier. Professional liability has a different nature. The consulting professionals volunteer to sell their services, inducing reliance thereon, and so are more likely to attract liability. The resulting problem is that, although other categories of defendant have benefitted from the reversal of the judicial trend and from its new caution, there is much less evidence of any such reversal in the judicial development of professional negligence liability. Therefore, the underlying problem for

professionals is that a claim might be made on virtually any project, with the possibility of potential liability for an indefinite period and for an unlimited amount.

Liability may arise in contract or tort. In contract, the establishment of liability requires proof of breach of the terms of the contract. Standard conditions of engagement used by professionals in the construction industry do not ordinarily seek to provide either positively defined duties or clear limits to the work being taken on. Contracts are often made informally. There is, therefore, ample scope for the interpretation of terms, actual or implied.

In tort, duties may be owed to a wide range of persons. The basis for the existence of such duty was described by Lord Atkin ⁽³⁾. The major consequence of Lord Atkin's principle is that it allowed a short-cut to claims via the chain of contracts from original manufacturer to end user. The later expansion of negligence liability, reaching its zenith in the *Junior Books* case ⁽⁴⁾, reduced even further the relevance of the contractual chain. That expansion has been shown to have been wrong (at least outside the professional negligence context) and the limits on non-professional negligence liability have been all but restored.

The courts are currently engaged in defining what type of damage tortious duty covers. Particularly in non-professional negligence cases, it now appears that only the cost of remedying damage to the plaintiff's person or property, together with financial loss immediately consequential to that physical damage, will ordinarily be recoverable. Wholly financial losses not consequent upon the physical damage are not normally recoverable in non-professional cases. Tort law is concerned with dangerous defects, not defects in quality. This effectively mitigates the potential liability of the professional but leads to even greater uncertainty, at least in the short term. The law will not necessarily hold a defendant liable in tort even if proved to have been 'negligent'.

There is one well established category for the recovery of pure economic loss in tort — that is, cases of professional advice which lead only to financial losses, where it is reasonable for the plaintiff to have relied on the special expertise held out by the adviser (*Hedley Byrne & Co* ⁽⁵⁾). The current tendency seems to be to treat the *Hedley Byrne* principle as depending on a voluntary assumption of responsibility, very close to contract, although very recent decisions indicate that the law is not clear.

In order to establish breach where a duty of care exists, whether in contract or in tort, it is necessary for the court to be satisfied that a lack of care has been proved. There is an important difference between liability based on fault and absolute liability. Yet there are very few cases in which the courts find that a professional has made an error, but without fault. Even where the court has made such a finding, it has usually been on the basis that the professional was not liable for the work in question, rather than that the error was non-culpable. Even in the absence of a voluntary assumption of responsibility, the courts may treat actual reliance by a third party claimant on a professional's advice or judgement as sufficient to justify a claim. Lord Justice Bingham has expressed considerable caution as to the judicial finding of professional negligence, and in 1957 sought to restate what the principles should be, as follows — "The law required of a professional man that he live up to the standard of the ordinary skilled man exercising and professing to have his special professional skill" ⁽⁶⁾.

5.3 The Institutions' and Associations' Assessments

All respondents firmly supported the principle that clients are entitled to projects which are in accord with design briefs and are completed on time and within budget. They also accepted that, if these objectives are not achieved, clients are entitled to redress. However, when matters go awry, in the great majority of cases damage cannot be attributed to one certain cause. The activities of each of the producers contribute to and draw on the activities of the others, although their services are procured differently with different liabilities.

Further, it does not follow that an actual failure of service is necessarily the liability of any producer. Clients then have no remedy unless one or more of the producers has accepted strict liability for the fitness for purpose of the project, which may or may not include completion on time and within budget. Thus, there is no certainty of entitlement to redress and there is no certainty of prompt payment because the uncertainties of the facts, circumstances and law are normally resolved only by protracted and costly litigation with an uncertain outcome. Setting to one side the uncertainties in law, there is no certainty as to whether compensation is available, if this hinges on claims-made PI insurance, renewed annually, perhaps by five or more independent consultants, each having different insurance with different terms and conditions.

There was near unanimity amongst the institutions and associations responding to the study

that construction law is unnecessarily complex and highly uncertain. This is not to the advantage of either the professionals or their clients or other claimants. Uncertain responsibilities, rights and liabilities inevitably lead to the expenditure of time and costs on actions which, with the benefit of hindsight, ought neither to have been launched nor defended. Moreover, the combination of contribution proceedings on the one hand and the existence of PI insurance for most professional practices on the other has both positively invited claims and caused practices and their insurers to shoulder more than their proper share of damages.

There are probably three principal causes of these difficulties which may be unique to construction. Firstly, statute law encompasses the whole spectrum of commercial, business and social activity, not just the special circumstances of the construction industry. Secondly, judge-made law has been responsive to changes in social perceptions of consumers rights. Thirdly, recent changes in the structure of the industry and in design and technology have made the processes of the industry even more interrelated, thus greatly increasing the problem of defining responsibilities and liabilities.

The quotations below, taken from one response submitted to the Study Team, are representative:

“From the viewpoint of the construction industry, the main objections to the law of negligence are that it is complex and uncertain and that, in important respects, it is insufficiently realistic and acts unreasonably. In referring to the law of negligence in this way, it is intended to include also the ancillary parts of the law which apply in conjunction with it, such as joint and several and vicarious liability, contribution, concurrent liability in tort and contract and certain aspects of limitation.

While there may be room for argument as to whether or not the law is unrealistic or unreasonable in a particular context, the objection regarding its complexity and uncertainty is surely beyond dispute. In this regard, the law is failing in the service it should be providing, since it is a fundamental necessity for commerce and industry in general, including the various professions that serve it, that the law should be readily comprehensible and reasonably certain, at least with regard to the principles involved. These features are probably second only in their importance to judicial competence and impartiality”.

Clients' rights were judged to be no better served and to merit reform of the law on their own account:

“The customer has a right to redress should [a consultant's] performance be less than that agreed”.

“In our view the objectives for reform should be: certainty as to the period during which compensation will be available; certainty as to the amount of compensation; certainty as to prompt compensation and, one might add, certainty as to the entitlement to compensation”.

Proposals for reform were of three kinds: radical reform better to assign risks and liabilities; consolidation of the relevant law by a Construction Law Bill; and amendments to legislation together with other measures to reduce uncertainty.

5.4 Comprehensive Solutions

5.4.1 Foreword

Radical alternatives to the current arrangements, designed to lead to more equitable and efficient risk sharing, were put to the Study Team by many of the respondents. They may be grouped under three general headings; limited liability, mandatory PI insurance and material damage insurance for the most costly latent defects.

5.4.2 Limited Liability

Unless excluded or limited by express agreement, construction professionals have unlimited liability for the consequences of their negligent acts or omissions. In practice, they obtain limited PI insurance cover which is unlikely to be capable of meeting the largest claims to which they may be exposed, for example a combination of latent damage and consequential costs. A recent report by the International Bar Association has advocated the capping of liability, subject to appropriate safeguards in cases of death or personal injury, for all professionals, provided they obtain the necessary insurance ⁽⁸⁾.

A number of considerations support the case for capped liability. They include the balance of risk between a limited liability company or public authority and consultants, the relationship between fees and liability and the balance between possible advantages and risk. The very great majority of the industry's significant clients are either limited liability companies or public corporations. In theory, individual professionals employed by companies and

public corporations are personally liable for their negligent acts, although employees, apart from directors who cannot be indemnified, are normally indemnified by their employers.

A contract with a partnership is a contract with all the partners who are jointly and severally responsible for the acts of their fellows. Against this background, many consider that it is unreasonable for consultants to be liable without limitation. Most consultants are relatively weak when compared with limited liability companies and public corporations.

The related issue of principle is whether it is reasonable for a small fee to give rise to unlimited liability. This may be illustrated by a case study. A small survey, made for a £100 fee, led to a six weeks' court hearing of a claim for £400,000 plus interest in respect of the development, which had been much less profitable than expected. The case was dismissed with costs of £500,000, which would not have met the full costs of the defendant's involvement.

It would be more reasonable, it was argued, if there were a sensible relationship between fees earned and liability, and between risks incurred and the maximum benefit that can flow from an undertaking. Consultants earn once-and-for-all fees and incur the liability of paying the premiums for PI insurance for many years. Clients obtain a flow of benefits for many years, often out of all proportion to their consultants' fees.

These arguments suggest that the principle of unlimited liability is not reasonable. Indeed, it may be a powerfully distorting factor leading to unnecessary litigation and to excessively costly PI insurance premiums, without any compensating benefits of improved competitiveness or efficiency. Also, the range of activities of construction professionals points to capped liability having some relationship to the fee earned rather than to a single figure.

5.4.3 *Mandatory PI Insurance*

One of the arguments advanced for capped liability is that it would make PI insurance more affordable to every practising member of the construction professions, apart from very small firms and those with a poor claims experience. Thus PI insurance could be made mandatory as a quid pro quo for capped liability.

All involved with clients, typically in the public sector, who insist on very high levels of PI insurance cover would benefit. Such costs can be material when an excessive PI insurance

requirement is unthinkingly imposed on all specialist sub-consultants who are expected to maintain the high level of cover for many years after project completion. This policy cannot be cost-effective for either the consultants or the clients. In the long term, the latter must pay indirectly for the cost of additional cover.

Compliance with mandatory insurance would need to be monitored and enforced. Four possibilities for a suitable authority are:

- a statutory body;
- a non-statutory body overseen and funded by the group of insurers writing PI insurance;
- the relevant professional institutions and associations;
- independent quality assurance scheme auditors.

5.4.4 *Material Damage Insurance*

Many assert that clients should insure the most costly categories of latent damage. This goes to the heart of the matter, which is to put right defects and damage without the need for proof of breach of contract or negligence, and to ensure that the procedures to recover the cost of repairs are certain and quick. With capped liability, this form of insurance would protect clients against catastrophe and would probably be more cost effective than PI insurance.

The Building Users Insurance against Latent Defects (BUILD), advocated by NEDO:

- provides non-cancellable material damage insurance against specified latent defects and damage for a period of ten years from the date of practical completion;
- is negotiated by developers and is assignable to successive owners and to tenants of whole buildings;
- involves a single premium, possibly paid in two stages or by instalments.

5.4.5 *Strict Liability*

Arguments for capped liability and mandatory PI insurance are that they would restore trust, avoid protracted litigation and achieve timely redress. Clients may press for general fitness for purpose or strict liability as a balancing concession; indeed, the British Property Federation is in the van. General fitness for purpose is often advanced as the less onerous criterion of performance but it was seen by the Study Team

as opening up too many possibilities, unless the criteria were circumscribed and tightly defined.

The operation of strict liability can be more certain, in that it can be limited to aspects of performance with verifiable and defined tolerance limits. There are four difficulties. Firstly, it is not possible to achieve assured standards in construction; there is always a residual risk which may be reduced, but not eliminated, by progressively more costly solutions. Secondly, it would be unreasonable, given the normal distribution of responsibilities, to impose strict liability on any particular producer unless that producer had absolute control of the whole process. Thirdly, important elements of the building would not be included. Finally, it is known that some accepted standards do not always lead to reliable results.

The Team noted that the professions believe that the courts are increasingly inclined to presume negligence or breach of duty on proof of damage.

5.5 A Construction Law Bill

Two arguments are advanced for a construction law bill. Firstly, the minimum reforms needed to create a more certain environment for the construction professions and their clients involve amending general acts in the particular interests of the construction industry. It has been put to the Study Team that these would be better handled as part of a bill concerned specifically with construction industry problems.

Secondly, during the past two decades, judge-made law has first extended then restricted liability in tort to the extent that different legal liabilities have been in force when projects were undertaken, when damage was discovered and a decision made to litigate, and when the action was finally decided. These circumstances are illustrated in the hypothetical case set out at Annex B, Appendix B1. Whilst judge-made law has the advantage of responding to changing social perceptions and commercial practice, it is retrospective and unfair if the rate of change is such that claimants and defendants are confused and uncertain. Moreover, the process itself is necessarily uncertain. Decisions emerging from particular actions leave important general issues unresolved. When the appeal in the *D & F Estates* case was decided in July 1988, important questions were not determined, for example what amounts to 'other property' and whether this could be met by Lord Bridge's hypothesis that in cases of 'complex structures' other distinct parts could be treated as 'separate

property' from the part that had given rise to the danger. Are the costs of averting danger now recoverable as damages? Lord Bridge's and Lord Oliver's speeches do not seem consistent on this vital issue. Hence, although the general thrust of policy is now clear, its application is uncertain.

The industry and its clients might benefit if these and other uncertainties were resolved and embodied in statute together with the amending legislation recommended by the Study Team. There are two countervailing arguments. Firstly, the boundary problems would be complex. Secondly, current initiatives related to European Community (EC) harmonisation may result in Community-wide reforms leading to legislation by Member States. At that time, there would be the opportunity to consider the merits of incorporating aspects of tort law in the framework provided by the EC legislation.

5.6 Control of Uncertainty

5.6.1 *The Responsibilities of Professionals*

Two concerns were put to the Study Team — the undue expectations of the public and the courts and the possibility of limiting liabilities by the terms of engagement. Many clients appear to expect that standards in construction work should be comparable with those that can be achieved in manufacturing industries. On occasions, the courts have been perceived by the professions as acting as though the issue was not what was reasonable in any particular situation but, rather, whether some argument could be found by which an act or omission could be considered negligent. The consequence of raising standards in any particular case, perhaps in order to avoid hardship for the plaintiff, is that these standards form a precedent for later cases or at least raise expectations. The benefits of raised standards are likely to be enjoyed by all subsequent plaintiffs, regardless of whether they would suffer hardship.

Professionals are, of course, able to define and restrict their liabilities explicitly. While contracts for construction involve detailed drafting to ensure proper performance, terms of engagement for professionals are usually brief and expressed in general terms. Payment is usually related to the capital cost of the project, a fixed fee, an hourly rate or some similar arrangement, none of which requires great sophistication. The brief is also expressed in terms of the project or other intended purpose, often with little or no reference to the way in which the commission will be fulfilled.

It has always been open to the professions, subject to the Unfair Contract Terms Act 1977, to incorporate exclusion clauses in conditions of engagement, for example for the coordination of other consultants or for supervision, but this approach has never been seriously adopted by any of the leading professional bodies. Apart from difficulties of drafting and adverse commercial effects, there is now the additional statutory hurdle of whether a clause is fair and reasonable having regard to the circumstances which were or ought reasonably to have been known to or in the contemplation of the parties when the contract was made.

The intention of the Unfair Contract Terms Act is made plain in a passage from a letter from the Office of Fair Trading (Annex B, Appendix B2). A statutory register of standard exclusions, approved by the relevant professional institutions, was commended by one institution. Clearly this would not circumvent the Act, although it might help to establish norms of accepted practice.

5.6.2 *Limitation of Actions*

The law of limitation of actions relating to latent defects is of particular importance to the construction industry. Defects may not be discoverable for some years after practical completion and professionals' liability may greatly exceed any available assets. PI insurance is vital as long as a claim may be brought, which extends to the period after retirement of any sole practitioner or partner. It is therefore particularly unfortunate that recent developments in the law have left the position so uncertain that the potentially liable rarely know with confidence when they can release their insurance or destroy their records.

The relevant features of the law of limitation of actions in English law may be summarised as follows:

- a claim in contract must be brought within 6 years (12 if the contract is under seal) of the breach;
- a claim in tort for negligence must be brought within 6 years of the cause of action arising, this being the occurrence of relevant damage, whether or not this is discoverable;
- a claim may also be brought in tort for negligence within 3 years of the damage first becoming reasonably discoverable;
- no claim for tortious negligence may be brought after the expiry of 15 years from the negligent act;

- no limitation applies where the relevant act has been deliberately concealed and;
- limitation periods do not protect a defendant from liability in contribution proceedings brought by other defendants.

The particular difficulties which arise in regard to determining whether a claim is statute barred are first to determine what is material damage, secondly to decide when the plaintiff could have been aware of it and thirdly what was the last act of negligence. The third matter is of particular difficulty in view of the possibility of duties extending after completion of the works. An added complication is that the professional may be joined in the proceedings for contribution by another party who is or may be liable. In such a case, the contribution claim can be brought up to two years after the date on which the other party is held liable, which may further extend the effective period of liability.

The English law of limitation of actions does not apply in Scotland, where the Prescription and Limitation (Scotland) Act 1973 applies. The provisions of the Act of 1973 differ from the equivalent English provisions. In so far as latent damage is concerned, the Act of 1973 provided for the discoverability concept, whereby, in a case where damage is initially latent, the starting point for the prescriptive period becomes the point at which the pursuer first becomes aware, or could with reasonable diligence have become so aware, that the loss, injury or damage caused by an act, neglect or default has occurred. At the time of preparing this Report, the Study Team is aware that the Scottish Law Commission is reviewing the law of prescription and limitation with regard to latent damage, and understands that the Commission is likely to issue a Report later in 1989 containing recommendations for reform.

Almost all the respondents to the review, including the British Property Federation, agreed that ten years after practical completion or the date of effective occupation in the absence of a certificate of practical completion, staged if necessary, is an acceptable compromise. Ten years is sufficient for the great majority of defects attributable to a fault to emerge; it is the maximum period for which material damage insurance is likely to be available; it is the period used in France, where such insurance is available; and it is the period of cut-off which now applies to manufactured and similar articles under the Consumer Protection Act 1987. It is also the period proposed for

the project-linked material damage policies referred to in Section 4.

In the Study Team's opinion, there appear to be both operational and legal arguments for having the same limitation periods for actions in tort and contract. In this respect, the Scottish Law Commission, in its recent report on 'Requirements for Writing' in Scotland, has recommended that the equivalent provision in the Prescription and Limitation (Scotland) Act 1973 should be repealed. In England, this could be achieved for negligent actions by amending the Limitation Act 1980 (as amended by the Latent Damage Act 1986) in one of two ways.

Firstly, the 15 years' longstop could be reduced to ten years. Nevertheless, the inevitable uncertainties of determining either the date of the occurrence of relevant damage or the date of the damage first becoming reasonably discoverable would remain.

Although the burden of retaining papers for, perhaps, 20 years after completion would be reduced, there would still be need to retain them long after the ten years limitation period. Moreover, the major uncertainties of determining dates of accrual of action would continue to generate hard fought litigation and, on current experience, appeals. Finally, the ten year limitation period of the Consumer Protection Act 1987 provides an absolute longstop, one which extinguishes the right rather than merely barring the remedy. This follows the approach adopted by the EC.

The second possibility is to amend the Limitation Act to provide a common absolute limitation period for negligent actions of 10 years from completion, the deemed date of accrual of the cause of action for actions in tort and actions in contract. This would have the following consequences:

- there would be no need to determine either the date of the occurrence of the relevant damage, or of that damage being reasonably discoverable. Two current major sources of uncertainty would be removed;
- the problems arising from the practical effect of the tests relating to the knowledge which a plaintiff should have in order to bring an action in tort would no longer apply. This would resolve the concern of the Institution of Civil Engineers about the consequences of the definitions in Section 14A of the Latent Damage Act 1986.

The Prescription and Limitation (Scotland) Act 1973 could be similarly amended.

The second alternative would lead to much greater certainty than the first; it would relieve consultants and their clients of the considerable task of retaining papers for, perhaps, two decades after completion, and would be consistent with other legislation emanating from EC harmonisation. It is preferred.

The Institution of Civil Engineers is concerned about the consequences of the definition of concealment employed in Section 32 of the Latent Damage Act 1986. This provides for the postponement of a limitation period where there has been a deliberate concealment of relevant facts by the defendant. While there is no objection to this in principle, the definition adopted in the Act could yield unintended results when applied to construction, which inevitably entails successive operations concealing preceding work. The Study Team concurs. A better form of words is the form of words used in the Limitation Act 1939, 'fraudulent concealment'.

5.6.3 *Joint Liability*

The law of liability for damages where others are partly liable in respect of the same damage, when viewed from the position of a construction professional, is seen as creating great unfairness amounting to injustice. Reports of judgments given by the courts in which a plaintiff is successful against more than one defendant often gives the layman the impression that the judge has held, say, one defendant 25 per cent liable to the plaintiff and the other defendant 75 per cent liable to the plaintiff. This is not so. The plaintiff is entitled to recover 100 per cent from any defendant. The apportionment reported is as between the defendants and, if any one of them is unable to pay, those who can must bear the loss.

The problems of joint liability are not unique to the construction industry but they do take a particularly acute form. In the construction industry, the parties tend to assume concurrent liabilities where there are several professionals whose work may interact and who may also be concerned with the performance of contractors and sub-contractors. As the use of management contracting or project management increases, there will be even more potential concurrent liabilities. Professionals would be much more ready to accept liability for errors if that liability were limited to a fair proportion of the loss, having regard to the relative degree of blame.

All the professional institutions and associations argue that this is how the law ought to work.

The disadvantages of the present arrangements are that they:

- positively encourage the pursuit of insurers' 'deep pockets' by joining several consultants in actions;
- greatly increase consultants' exposure to being joined in actions for which they have no real culpability;
- lead consultants and their insurers to pay more than their fair share of negotiated settlements; and
- lead occasionally to an unfair apportionment of damages and costs in relation to the adjudged fault.

Consultants' experience is illustrated by the following quotation from comments appended to a completed questionnaire:

"The heaviest claims which have been faced by this practice to date, including claims currently made and two overseas claims affecting associated practices, are claims where we pick up a much greater liability than would otherwise be the case if all the participants in the original project were parties to the action. Our experience is that this distortion is very common, particularly in the case of those specialist sub-contractors who carry out a large, costly and complex element of the works, for example cladding and curtain walling. Whatever direct warranties may be obtained from a sub-contractor to the client, these are never backed by insurance and this leaves the consultant exposed in the inevitable liquidation of the sub-contractor. This distortion applies equally in claims for negligent supervision where the sub-contractor who carried out the work is no longer in existence".

A number of the relevant case studies made available to the Study Team are at Annex B, Appendix B4. These amply demonstrate the effect of joint liability which makes consultants and sometimes contractors pay for the faults of others over whom they had no effective control. This is manifestly unfair where there are concurrent liabilities and no collusion, as is normally the case for construction projects.

The situation could be remedied by removing construction professionals from 100 per cent liability to the plaintiff where there is only

partial fault for the damage suffered. It might be objected that a plaintiff is also an innocent victim and ought not to have to face the consequences if one or more defendants are unavailable to meet their share of damages and costs. However, unlike defendants, clients can verify that all parties have sufficient financial backing whether by way of assets, bonding, insurance or parent company guarantees. Clients are well able to manage these risks and should, therefore, accept liability. An exception might be made for claims of less than, say, £50,000 made by domestic clients who will not have the experience or the resources needed to manage their risks.

5.6.4 *Legal Aid*

The RICS's submission asserted that plaintiffs assisted by Legal Aid put defendants at a great disadvantage because, for the plaintiff, the pursuit of litigation is relatively costless, whereas a successful defendant can seldom recover costs. Interviews confirmed that building surveyors share these opinions and, when faced with a legally aided claim, often promptly negotiate the best available settlement in order not to incur irrecoverable costs. This tactic, however, merely confirms the Legal Aid authorities' wisdom in supporting a plaintiff and provides no evidence to support the RICS's contention.

The response of the Lord Chancellor's Department to the RICS's proposals is at Annex B, Appendix B3. This explains that the courts may require an assisted person to pay his or her opponent's costs, although an assisted person's liability for costs shall not exceed the amount which is reasonable in his or her circumstances. Where severe financial hardship would be suffered, a successful unassisted party may obtain an order for his or her costs to be paid out of the Legal Aid fund if an assisted party had instituted the proceedings. Action is also in hand to provide further safeguards against injustice arising from Legal Aid.

5.7 **The Study Team's Assessment**

The Study Team concluded that construction law is complex and highly uncertain. Claimants and professionals would both gain were it less complex and reasonably certain.

The Study Team accepted the arguments for, and potential benefits of, radical reform. It is not recommended for the following reasons:

- it would not be possible to justify legislation to limit professional liability for construction industry professionals

- without also considering the case for other professionals;
 - introducing mandatory PI insurance and material damage insurance would make heavy demands on insurance capacity;
 - strict liability could not be imposed except as part of a radical reform of the liabilities of all producers; and
 - the other recommendations of the Study Team should be given time to be effective and the consequences of European harmonisation, if any, should be digested before wide-ranging reform is attempted.
- although the RICS has argued for reform of Legal Aid so that costs can be recovered by a successful defendant, no recommendation should be made other than that the Legal Aid authorities should accept the form of short arbitration described in Section 6. The Lord Chancellor's Department is already increasing the safeguards, although not to the extent requested by the RICS.

The Team also concluded that:

- on the assumption that judge-made law is now more settled than in the past two decades, a construction law bill is not now justified. The need should be reviewed after the recommendations of the Study Team have taken effect and the outcome of EC harmonisation is known;
- although the case argued by the RICS for reducing the likelihood that disclaimers may be struck out deserves a sympathetic hearing, no action is necessary;
- the arguments are accepted for a common liability period which would extinguish the right of action ten years from the date of completion or effective occupation, staged if necessary, for actions in contract and in tort arising from negligence;
- there is a strong case for amending the definition of 'deliberate concealment' in the Limitation Act 1980 as amended by the Latent Damage Act 1986;
- there is a pressing need to ensure that defendants in actions arising from construction projects are liable for no more than their proper and equitable share of responsibility; and

References

- (1) Capper/Uff report to the Study Team.
- (2) Phillip Capper, 'Background of Liabilities' in 'Your Signature and Your Risk', Conference, RIBA Indemnity Research Ltd (1988).
- (3) *Donaghue v Stevenson* (1932) AC 562, 580.
- (4) *Junior Books v Veitchi* (1983) 1 AC 520.
- (5) *Hedley Byrne & Co v Heller & Partners* (1964) AC 465.
- (6) *Bolam v Friern HMC* (1957) WKR 582.
- (7) International Bar Association 'Proposals for Legislation' (1988).

Routes to Redress: Claims and Litigation

6.1 Foreword

A client's route to redress via a claim is one aspect of a commercial relationship which sometimes leads to litigation. The following discussion of claims derives from the questionnaire survey (Annex E) and the interview survey, whilst that of litigation derives both from the questionnaire survey and from an ad hoc analysis of the records of the Official Referees Court which examined samples of cases closed in 1982 and 1987 (Annex H).

Claims arise for many reasons other than an alleged fault. A long-standing association between client and consultant is unlikely to lead to claims launched simply to establish a negotiating position. An in-and-out developer is more likely to launch claims, since the working relationship will die with completion of the project. A public authority may litigate to avoid audit censure or to show that every reasonable step has been taken to recover damages and thus obtain funding for repairs. A claim may be triggered by the conflicts that arise in every project or in response to a consultant's claim for additional fees for abortive design. Other more significant causes are:

- an actual failure of a professional service, for example errors in structural surveys or design, significantly underestimated costs, negligent supervision of construction, misleading technical reports and so on;
- a contractor's claims for delay;
- poor control of project costs;
- economic losses arising from late completion;
- dissatisfaction with the quality or performance of a completed project;
- latent defects;
- a shortfall in expected profits leading to an attempt to recoup losses by raiding insurers' 'deep pockets'.

A claim is often no more than a stage in every-day negotiations. Many claims are not pursued and many are settled relatively quickly,

often for comparatively trivial sums. Some claims are preemptive, designed to circumvent a limitation period. Such claims are bad practice and are reprehensible when they lead to a consultant being removed from lists of approved practices. A minority of claims, perhaps 20 per cent, result in the service of a writ, which is the first stage of litigation.

6.2 The Incidence of Claims and Litigation

PI insurance policy conditions require insurers to be notified of circumstances that may lead to a claim. There is no universally accepted definition of a claims circumstance. Changed definitions imposed by insurers can generate an apparent surge in notifications. Failure to report a circumstance may void a policy; over zealous reporting can give the wrong impression to a potential insurer. Practice varies widely. Smaller consultants appear to report all potential circumstances; a major consultant with a long association with a broker or insurer may have more discretion. Table 6.1 shows the trend of claims circumstances notified to brokers and insurers.

Table 6.1 The Trend of Claims Circumstances

	<i>Notifications per 100 policies per year</i>			
	1982	1984	1986	1988
Architects	50	—	70	65
Buildings Surveyors	31	42	42	46
Civil Engineers	68	86	71	121 *
Services Engineers	60	76	63	98 *
Structural Engineers	63	76	69	92 *
Quantity Surveyors	8	10	9	9

Sources: various brokers and insurers.

*These significant increases were said to be the outcome of changed rules.

About 75 per cent of respondents to the clients' questionnaire reported that the incidence of claims experienced had either no or only a slight effect on the way professional services are procured. Private sector clients, with significant annual construction programmes, had experienced very little litigation with their consultants. About one half had never issued a writ; none had issued more than one writ. The

consultants' responses were consistent. About one third asserted that they had never reported a claims circumstance. The consultants interviewed confirmed this experience. Depending on the discipline, the number of claims circumstances varied from roughly one for very few professional man years for building surveyors to one per 10 to 50 man years for the design professions, with the larger consultancies reporting higher ratios. Quantity surveying practices reported few claims circumstances.

A survey of the records of the Official Referees Courts (Annex H) examined samples of cases closed in 1982 and 1987. One set of files exists for each writ registered with the court, racked in date order of closure—that is, when a case is withdrawn, dismissed, settled by negotiation (recorded as a consent order) or is the subject of a court award. Of the 798 writs registered in 1982, 155 (20 per cent) are estimated to have involved professionals; the corresponding figures for 1987 are 1,114 writs of which 280 (27.5 per cent) are estimated to have involved professionals. The risk of a project leading to a writ is small. Assuming cases are being closed at the same rate as writs are registered, the 1987 data indicate that roughly one in 170 building projects and roughly one in 250 civil engineering projects resulted in a writ (a project being defined, for statistical reasons, as one for which the tender exceeded £25,000 at 1978 prices).

6.3 Is Litigation Increasing?

Table 6.1 is difficult to interpret. Almost certainly there was a significant increase in claims circumstances in the late 1970s and early 1980s. Since then, the volume of claims has been variable but not obviously increasing, if account is taken of the new criteria for reporting claims circumstances to some insurers. The Official Referees Court data suggest that writs against professionals are increasing and a greater proportion may be decided by a court award.

Cases closed in 1982 were estimated to have been registered in January 1979 and those closed in 1987 to have been registered in December 1984. On this basis, the number of writs involving professionals increased by 11 per cent per annum, a rate of increase which would double in about seven years the number of writs registered. More recently, the number of writs registered with the Official Referees Court has averaged about 1,100 annually. However, during the years 1982 to 1987, the percentage of 'professional' cases in the sample increased from 20 to 27.5 per cent. Were this increase of 1.5 per cent per year to be maintained and the

number of writs to remain constant, there could be about 400 'professional' cases in 1995 compared with 280 in 1987 and 155 in 1982. Another indicator is the proportion of settled cases decided by a court award. This rose from five per cent in 1982 to 15 per cent in 1987. On inspection, cases launched by private clients accounted for the bulk of the increase. Also, the proportion of local authorities and housing associations involved is higher than their share of the workload.

The trend is not dramatic but the indicators all point in the same direction; the number of 'professional' writs will continue to increase. This was also the expectation of a meeting of very experienced construction law solicitors. They agreed that the mosaic of much amended conditions of engagement and contracts, duty of care letters, collateral warranties and guarantees would pave the way to burgeoning litigation in the 1990s.

6.4 Litigation: The Process

The nature of litigation in the construction industry is made plain by the following quotation from the questionnaire survey:

"Once proceedings are issued, the system fuels the dispute. Allegations of negligence are drawn up very widely and will typically include peripheral allegations which nevertheless have to be considered, reported on and defended as fully as the central allegations. Perhaps a greater readiness to award costs against the plaintiff for allegations not made out might reduce this tendency.

The amount of the claim is put at the highest possible, which thwarts the possibility of an early settlement. Any remedial scheme proposed by those advising the plaintiff will inevitably be a belt and braces one, so it is unusual for this to be agreed between the parties and arguments about the excessive or unreasonable remedial scheme will absorb an enormous amount of money and time, although such arguments are unlikely to make much headway before the court.

Unfortunately, the experts for either party usually adopt positions and the plaintiff's experts do not tend to reflect generally prevailing standards at the time the project was designed and constructed. In our experience, independent experts are not sufficiently independent and are excessively restricted by those instructing them for the potential benefits from without prejudice meetings to materialise.

All these factors obstruct the possibility of a fair and speedy resolution once proceedings are issued. The professional believes with

some justification, whatever lip service is paid to the standard of reasonable skill and care, that, if there is a problem, the court will tend to attribute liability to someone. The cost, and in particular the cost of senior people involved in properly preparing a case for trial, is an overwhelming incentive to settle. Plaintiffs and those advising them rely on this and so the process goes on”.

Interviews with clients and consultants confirmed the belief that negotiated settlements become much more difficult once writs have been served. Plaintiffs sometimes appoint solicitors with insufficient experience in construction litigation, which is now a recognised specialism. Solicitors, pursuing what they consider the best interests of their clients, will resist a negotiated settlement as long as outright victory is a reasonable possibility. Moreover, one consequence of an adversarial procedure is that everything is thrown into the pot. Inflated claims lead to inflated expectations and more detailed investigations, and make a negotiated settlement less likely. Some public authorities lack the strength of management to pull together the differing views of their client, policy, technical and finance departments, and to make difficult decisions which may be open to censure. In one case, it was reported that “litigation is bumbling along because nobody is able and willing to halt the process”. Some plaintiffs and some defendants are determined to pursue litigation to the bitter end.

In complex cases, that which has to be done is inevitably time-consuming. Experts’ investigations may be extensive and discovery is a major task. Often, it is in the interest of one or more of the parties to delay. The courts will normally intervene only when asked to act. Therefore, within practical limits, the time taken to conclude a case lies with the litigants. As each milestone is passed, costs mount rapidly; for example, a multi-party hearing can easily cost between £10,000 and £15,000 a day. Providing all the parties are sensitive to mounting costs and are capable of making unpalatable decisions, the advantage of reaching a negotiated settlement increases as each milestone is approached. Moreover, the courts will provide adjournments if there is any prospect of a negotiated settlement. Despite these apparent advantages, negotiated settlements are often achieved no more quickly than are court awards.

It has recently been suggested that County Court jurisdiction should be increased. The Study Team would welcome this as providing an

avenue to redress which should keep down costs and reduce delay in the settlement of small claims.

Table 6.2 illustrates that the various changes in the court’s rules have led to a shortening of the average elapsed time from registration of a writ to a negotiated settlement or award, which is less affected by the value of the settlement or award than was expected. There is, roughly, a 25 per cent shortening of the average elapsed time between 1982 and 1987.

Table 6.2 Elapsed time from registration of writ to negotiated settlement or award

<i>Duration of cases by size of awards or settlements</i>					
<i>Settlement Award £k</i>		<i>1982 No of awards</i>	<i>Average duration (months)</i>	<i>1987 No of awards</i>	<i>Average duration (months)</i>
0<	5	7	29.6	7	30.7
5<	10	7	33.7	5	24.2
10<	25	14	38.6	18	37.2
25<	50	3	38.0	14	24.6
50<	100	12	42.1	12	27.9
100<	250	2	83.0	6	34.3
250<	500	4	50.3	3	32.7
500—		—	—	3	33.7
Total		49	40.7	68	30.8

Source: Annex H.
(i) The amounts of awards or settlements in 1982 have been adjusted to 1987 prices using the all-in building tender price index.
(ii) Duration: date of writ to date of settlement or award.

No way was found to estimate the total cost of litigation. The mere lodging of a claim incurs direct and irrecoverable costs to client and consultant alike, imposed by the need to investigate the alleged problem and decide tactics. Costs accrue rapidly once a claim is pressed home, as further investigations are made, solicitors and insurers consulted and settlements sought. Once writs are issued, although insurers manage litigation and appoint solicitors, counsel and experts, consultants have a continuing and heavy involvement in servicing cases. Plaintiffs are no better placed. Costs are normally merged into negotiated settlements. When settled by a court award, damages and costs are sometimes stated, but often the delay before the taxing master can assess costs may result in their not being recorded. Insurers record separately only the fees paid to those representing the defendant. There is no direct way of ascertaining the total costs of plaintiffs and of all the defendants. It is certain that they often exceed by many times the amount of settlement or award and are a powerful inducement to settle.

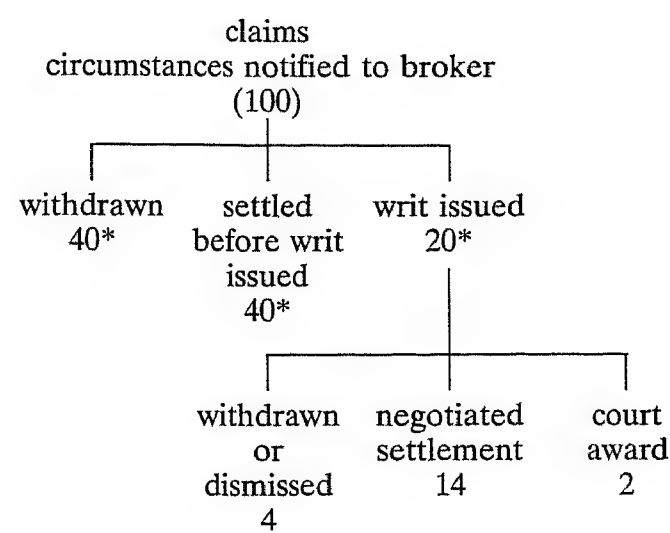
What is clear is that litigation is a burden and distraction for all who become enmeshed in its snare. Apart from direct legal costs, which may be partially recovered or met by insurance, there is the opportunity cost of the time of directors, managers, partners and senior professionals. This may be absorbed as an unwelcome and unnecessary on-cost by large organisations. Its effect on small organisations is very much greater, and the small professional practice is especially vulnerable.

6.5 Litigation: The Outcome

On the basis of the survey of the records of the Official Referees Court, once litigation commences 20 to 30 per cent of writs are withdrawn or struck out, 60 to 70 per cent are negotiated and 5 to 15 per cent are subject to a court award. These estimates are very variable, not only between years but between disciplines. Figure 6.1 indicates the *approximate* conversion of notified claims circumstances.

The currently high level of deductibles gives consultants greater scope to negotiate ‘commercially sensible’ settlements with the agreement of their insurers. In addition to avoiding litigation and all its costs and uncertainty, a quick, negotiated settlement maintains client relationships, which may be the overriding consideration. Settlements prior to litigation probably account for the majority of claims by domestic clients (principally against building

Figure 6.1 Conversion of potential claims circumstances into litigation



*roughly assessed from interviews.

surveyors) and of claims where a consultant has clearly made a design error. The aggregate of these payments is not known; there are no available data. Of the 363 cases reported in the questionnaire survey, almost 50 per cent were settled in this way, with payments averaging £58,000.

Architects, surveyors and engineers have very different experience of litigation. Table 6.3 summarises the outcome of cases inspected in the survey of the Official Referees Court’s records.

It is clear from the above analysis that litigation is not without risk to plaintiffs. They lost 21 per

Table 6.3 Analysis of settlements and awards (including costs) by defendant profession

	Year	Cases	Withdrawn or Dismissed % of (2)	Settle- ment or award % of all awards (4)	Settlement or Awards		
					Minimum £k	Median £k	Maximum £k
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Architects	82	50	29	48	1	31	291
	87	49	32	40	2	25	522
Surveyors	82	15	10	4	2	9	46
	87	23	24	9	3	20	115
Engineers	82	22	7	28	4	24	305
	87	18	35	39	1	59	725
Not Specified	82	13	22	20	3	16	280
	87	10	36	12	10	50	350
All	82	68*	21		1	13	305
	87	110*	31		1	26	725

Source: Official Referees Court cases sampled (Annex H).
 (i) Settlements and awards include costs where known.
 * Actual numbers rather than percentages.

cent and 31 per cent of the cases terminating in 1982 and 1987 respectively. Successful claims often recover far less than the sum claimed, although this sum may have been inflated during litigation. Figure 6.2 indicates that the final settlement averages 55 per cent of the amount claimed, excluding the 25 per cent of cases for the two survey years which are, on average, withdrawn or dismissed.

The exposure of the defendants to litigation was not uniform:

- architects accounted for about half the defendants and half the payments in both years (albeit with roughly a 60 per cent increase in the number of cases);
- surveyors were involved in nearly one quarter of the cases in 1987—a significant increase—but only accounted for 9 per cent of the payments;
- although the percentage of engineers' cases fell from 22 to 18 per cent (of which 35 per cent involved no payment), their share of payments rose from 28 per cent to 39 per cent in 1987.

Naturally, these differences are reflected in the settlement of claims in the various professions, with median payments of £25,000, £20,000 and £59,000 in 1987 for architects, surveyors and engineers respectively. Some cases were settled for comparatively trivial sums which could not have justified the cost and inconvenience of litigation. Conversely, the cost to insurers is dominated by the relatively few large awards (Table 6.4).

Table 6.4 Cumulative distribution of awards and settlements

% Cases in order of decreas- ing value	% Total awards and settlements							
	architects and designers		surveyors		engineers		all	
	1982	1987	1982	1987	1982	1987	1982	1987
top 10	45	52	38	32	58	42	52	47
top 20	61	71	54	51	68	74	68	73
top 50	92	91	84	81	92	92	93	92
top 80	99	98	96	97	98	99	99	99

- (i) The percentage of claim recovered is *not* related to the value of a claim (Figs 7.1 and 7.2; Annex G).
- (ii) These percentages do not align with these of Table 7.8G which reports the response to "the sum recovered".

6.6 Alternative Disputes Resolution

In the United States, there is no technical court such as the Official Referees Court, with judges experienced in deciding construction law cases

and with procedures designed to expedite them. Possibly because of this, there are long delays before construction law cases come to trial. Consequently, methods of alternative disputes resolution have leapt into prominence as litigants have sought ways to settle their differences. At least one UK consultant has been offering these services for some years and one of the USA consultants active in this area has established a UK office. No doubt the supply would quickly expand to meet demand; all the skills exist.

Methods of alternative disputes resolution are of two types. The first group, which includes mediation and conciliation, facilitates a negotiated settlement by paving the way for the litigants to follow, sometimes with the mediator pointing to possible settlements. The second group includes arbitration, which, with its statutory basis in this country, is enforceable, and no-prejudice trials which can make an award which is not enforceable.

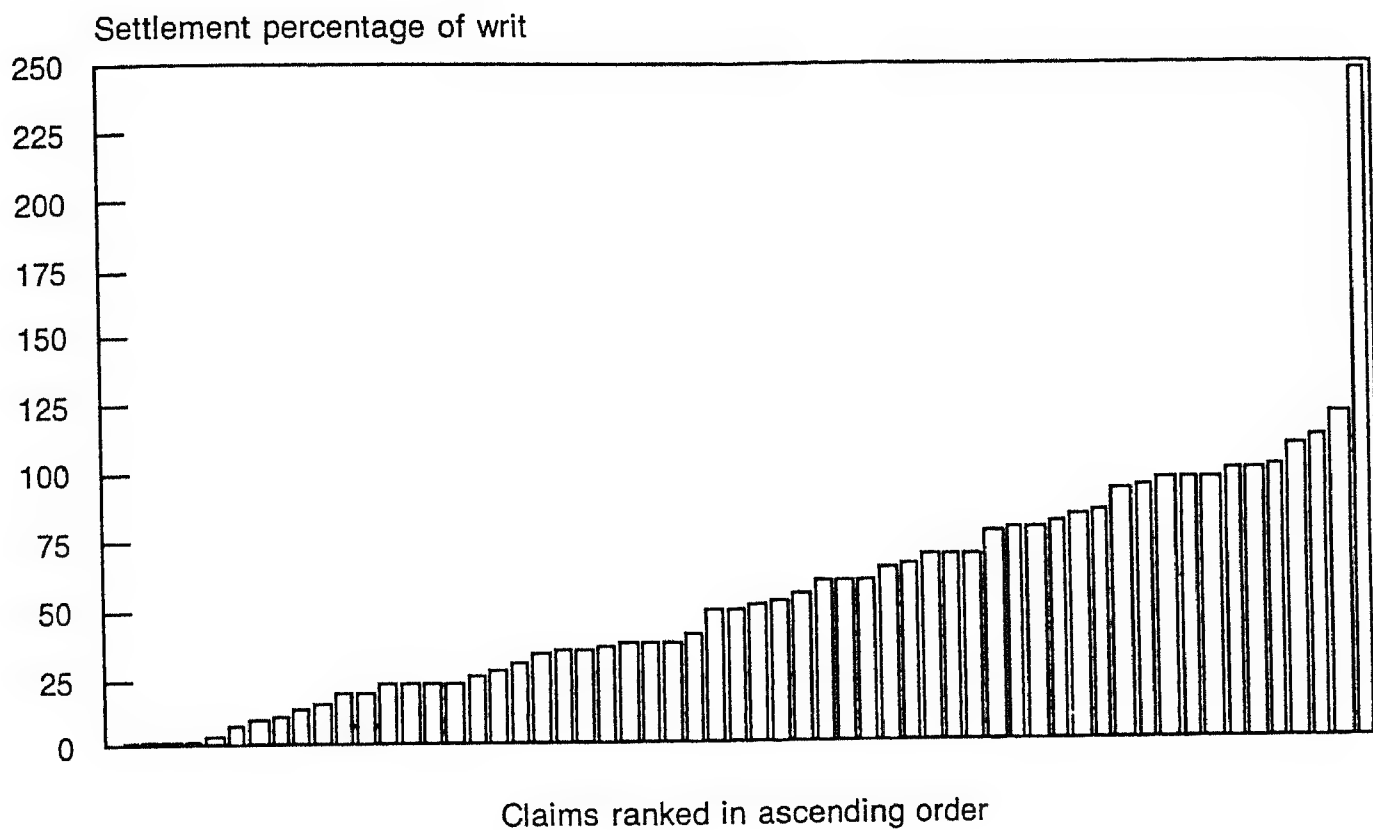
Except for arbitration decided on the basis of written submissions, the Association of Construction Law Arbitrators felt that arbitration did not have a major role in deciding multi-party professional indemnity cases. Given the existence of an effective technical court, it is unlikely that no-prejudice trials will make a significant contribution in this country. Unless the time to achieve a court award lengthens and costs rapidly increase, the authority of a court award will be preferred.

All methods of alternative disputes resolution have one feature in common. They depend critically upon the willingness of the parties to negotiate. This is less likely in multi-party actions, especially if there is the prospect of additional parties being joined. What role might these techniques play? In most circumstances, the solicitors representing the parties ought to be able to seek acceptable settlements. Indeed, this is one of their functions. However, the evident independence of conciliators fresh to the scene may be more likely to achieve a negotiated settlement. Conciliation clearly has a role which is yet to be fully exploited.

About one half of the Official Referees Court cases closed in 1982 and 40 per cent of those closed in 1987 were settled for less than £25,000. As the survey demonstrates, negotiated settlements are often no quicker than court awards and must be almost as costly. Therefore, there would be advantage in requiring disputes to be referred to 'papers-only' arbitration before a writ is issued and when the

Fig. 6.2 Settlement

Percentage of writ claim value



sum claimed is less than, say, £50,000⁽¹⁾. Such claims cannot possibly justify the time and cost of litigation.

Were this procedure operated across the professions and made part of revised conditions of engagement, a large proportion of claims currently leading to a writ could be settled. The RICS's limited experience is that reference to 'papers-only' arbitration is relatively cheap. Such a system would be of material assistance to occasional and domestic clients who do not have the funds or skills to launch litigation and may be deterred from so doing by the prospects of court proceedings. Also, were this procedure acceptable to the Legal Aid authorities, it would reduce the cost of actions to them and to defendants.

6.7 The Study Team's Assessment

The Team concluded that:

- litigation is likely to continue to increase;
- currently, clients and consultants are very apprehensive of the likelihood and consequences of litigation, although it is not yet at epidemic proportions;
- there is a continuing undercurrent of threatened claims which do not materialise. All demand an input from clients and consultants and, often, some

payment by the consultants to head off litigation and to preserve good relationships;

- experienced clients arrange their affairs so that litigation plays little part in their relationships with consultants. It is held in reserve for a catastrophic failure of service;
- other clients, who may have had less experience of handling their relations with the industry and have less power in the market place, launch claims, a high proportion of which are not pursued or are settled quickly;
- for many consultants, a claims circumstance is an unusual event and the service of a writ a very unusual event;
- involvement in major litigation is rare but is a very serious problem when it occurs. Apart from direct legal costs which may be recovered, there is a high opportunity cost of directors' and partners' time. This is especially important to small firms;
- consultants' apprehensions are aggravated by the fear of being joined in actions for alleged failures for which they had little or no responsibility;

- conciliation has a proper role which merits more attention in order to achieve quicker and cheaper settlements;
- an effective small claims procedure is needed for claims of less than, say, £50,000 arising from construction projects, to assist claimants and defendants and to relieve the courts of the burden of these cases; and
- the study has not revealed any issue that warrants an attempt to alter the accepted court procedures in the interests of the professions and their clients. Indeed, they are fortunate in having a court largely devoted to their interests. The Official Referees Court now has six courts in continuous session with judges immensely experienced in dealing with construction law and with special rules for the better handling of cases. The Official Referees Court does not exist, however, in Scotland.

References

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International Comparisons and Trends

7.1 Foreword

Attitudes towards professional liability and proposals for reform in other countries are of particular interest in the light of the advent of the Single European Market. As measures to achieve harmonisation in the European Community are introduced, it is important to consider potential models for professional liability and insurance which may emerge from the European debate.

The Study Team examined the arrangements covering professional liability and insurance in several countries. As the Atkins report⁽¹⁾ commented, such comparisons are also of interest because of the increasing impact of insurance requirements on UK consultants working overseas. A report by Peter Madge of Willis Wrightson Ltd was therefore commissioned to provide an up-to-date survey of current practice in eight countries (France, Portugal, West Germany, Australia, New Zealand, Denmark, Sweden and the USA). The report's conclusions were augmented by information from other sources, most notably the work of the International Working Commission on Post-Construction Liability (CIB W87)⁽²⁾. The additional data included coverage of Canada, the Netherlands and Belgium.

This section briefly describes the findings, with particular reference to the French system for decennial insurance, discusses the problems encountered and pressures for reform, and touches on the implications of the Single European Market for future developments.

7.2 Summary of Findings

To assist easy comparison, the information on the eight countries in the Madge report is summarised in the table at Annex C. Of the eleven countries studied, contractual liability is defined by statute in France, West Germany, Belgium, the Netherlands and part of Canada. Contractual terms are not fettered in the remaining countries, although, as in Denmark and Sweden, they may be regulated by an industry-wide convention. Tort liability is frequently defined in statute but the practice appears to be broadly similar in most countries.

France has the most comprehensive statutory control, deriving from the Napoleonic Code. It is the only country which has compulsory decennial liability insurance for architects, engineers and contractors, arising from the so-called Spinetta Law, 1979, amended in 1983. This takes the form of strict liability for damage affecting the 'solidity' of a building—in effect, structure and weather-proofing. PI insurance to cover minor works, consequential losses and third party claims may be taken out in addition by engineers, and is obligatory for architects. To prevent delay in funding repairs, building damage insurance ('dommage ouvrage') has also been made compulsory for property developers and hers. The 'dommage ouvrage' insurers have subrogation rights against the decennial insurers, with a concordat to the effect that the latter accept the allocation of blame determined by the 'dommage ouvrage' insurers' experts for claims up to about £62,000.

Belgium's Napoleonic Code is less draconian, making designers and builders, possibly including sub-contractors, but not other participants strictly liable for ten years for major defects. The Quebec Province of Canada and the Netherlands also impose strict liability. Elsewhere the criterion for liability is 'duty of care'.

In all the countries studied, PI insurance is voluntary (except for architects in France) but may be required, to a greater or lesser degree, by the professional institutions. Almost everywhere, proof of adequate PI insurance will be required by clients. Most countries other than France have few PI insurers, and these often rely heavily on reinsurance. All but France and Portugal have policies written on a claims-made basis. In France, the possibility of moving from the present occurrence basis to a claims-made basis is being examined.

Joint liability of defendants exists as a general principle in almost all countries for which data were collected. Full liability where there is only partial fault appears to be applied in its most vigorous form in the UK; in the other countries studied, practice is confused or application

difficult. The USA is a special case with different practice from state to state, some following UK precedent, others diluting it and others limiting damages to the an equitable share of blame. In Denmark, the clients' and professionals' organisations have made a concordat to the effect that consultants engaged under nationally agreed conditions are liable only for a just and equitable proportion of the damage suffered by the plaintiff, where there is more than one defendant.

Capping of liability occurs only in West Germany, by agreement between the parties, and in the Netherlands, where new arrangements have introduced a limitation related to fees, subject to lower and upper limits of roughly £45,000 and £450,000 respectively. The possibility of capping professional liability is being considered in Denmark.

The shortest limitation period on liability, three years from the date of discovery, is in Portugal. In the USA, the period is generally three or four years after discovery of damage and sometimes with a ten-year long-stop. Elsewhere, liability periods vary from 5-10 years after either breach or hand-over, except for France where, in exceptional circumstances, there is a 30 year liability period.

7.3 The French System

The main elements of the French liability arrangements have been mentioned above. The Atkins report has described the system in some detail, concluding that "it is still not clear whether the system will be effective and successful; it will be 1991 before the full ten year results of the first year's policies in 1979 become available; meanwhile, organisational changes are still being made and legal judgements affecting the interpretation of the extent of guarantees are still pending".

The Atkins report believed that the cost of insurance in the French system was high—an average of three to four per cent of project cost for 'dommage ouvrage' plus liability insurance. Recent indications are that the cost is more in the region of one per cent (this relates to inspection by a Bureau de Controle). It has been suggested that insurance premiums in France account for between 9 per cent and 19 per cent of a professional firm's annual turnover. The settlement of claims brought under 'dommage ouvrage' insurance has been fairly effective. Recent evidence suggests that 85 per cent of cases have been settled within the 20 weeks limit. The remaining 15 per cent have

taken longer, principally because claimants have contested the proposed compensation.

The relations between 'dommage ouvrage' insurers and decennial liability insurers are regulated by a general convention agreed in 1983. The 'dommage ouvrage' insurer has recourse to the decennial liability insurer for claims exceeding 7,000 FF (£650). The cause of damage and the cost of repairs are assessed by an expert appointed by the 'dommage ouvrage' insurer. Claims less than 670,000 FF (£62,000) are automatically reimbursed at a rate of 95 per cent. This convention generally avoids recourse to litigation and so far only ten cases have been the subject of appeals to the Commission de Conciliation. The fact that the share of the adjudged liability between designer, contractor, etc. is settled by an expert restricts the opportunities for defendants to defend themselves. Also, if a professional is frequently identified as liable, the rate of liability insurance for that practice will of course increase.

A particular problem is the definition of which products and components are critical to the 'solidity' of the structure and therefore carry decennial liability. To be so regarded, components must have an element of design in them, for example pre-cast panels but not bricks. In the event of damage, they must have behaved in such a way as to render a component part or service related to the premises unsuitable for the purpose for which it was intended. The French courts have had some difficulty in providing a consistent interpretation of these provisions in the Spinetta Law. There is also a problem about the liability of sub-contractors who are not included amongst the group of 'constructeurs' defined by statute. Their activities are regarded as the responsibility of the main contractor. In practice, their liabilities are not insured.

There is no doubt that claims resulting from damage arising from defects in buildings constructed in the 1960s forced a sharp rise in insurance premiums which continued after the introduction of the Spinetta Law in 1979. The French Government intervened and set up a compensation fund mainly to meet claims for damages in buildings completed before 1978. The fund is administered by a semi-public body, the 'Caisse Controle de Réassurance', partly financed by a surcharge on new policies. Even today, despite measures such as the establishment of a joint construction-insurance agency for the prevention of defects, the 'Agence Qualité Construction', and the strengthening of independent technical control

officers acting on behalf of the client, it has been estimated that the compensation fund will face a deficit of FF 1,000 million in 1989.

Nonetheless, in spite of several problems which have been identified, the French system appears to provide a climate of certainty for construction professionals and, for their clients, a means of relatively swift redress without recourse to litigation or the threat of litigation.

7.4 Problems and Pressures for Reform

The Study Team's enquiries have revealed an uneven pattern of dissatisfaction in the countries examined. In some countries, such as Canada, moves are being made to make professional liability more onerous, whilst in others, such as the Netherlands, it is being relaxed.

The uncertainty of the liability of sub-contractors in both Belgium and France has already been mentioned. In France, the amended Spinetta arrangements are unlikely to be revised again in the near future, although there is a general recognition of the anomalous position of sub-contractors and of the need to define better the circumstances in which building components carry decennial liability.

In Canada, a powerful consumer lobby has secured extensive legislation which is being implemented in stages, introducing criminal and civil liability and more stringent quality regulation. All these changes are designed to benefit the customer or client.

In the USA, considerable pressure is being exerted by professionals, including construction industry professionals, for legislative changes to limit the amount of liability in relation to fees and to extend to more States the abolition of joint and several liability. There is also an increasing emphasis in the USA on alternative disputes resolution schemes rather than binding arbitration or litigation. Some of the institutions are pressing for the acceptance of contractual indemnification and exculpation as a means of removing the liability of professionals; this is unlikely to be realised. In New Zealand and Australia, the professionals' case is based on concern for greater certainty and consistency. Recommendations include the reduction of limitation periods, the financial capping of liability and reform of the law on 'several concurrent tort-feasors' (that is, joint liability). There is widespread recognition of the need for more effective risk management.

7.5 The Single European Market

A wide range of measures which will contribute to opening up the European construction mar-

ket to Community-wide competition are included in the European Community's programme to implement the Single European Market. Not all of these measures will have a direct effect on liability and insurance arrangements in the Member States but, taken together, they will make it all the more desirable for problems that do exist to be addressed on a pan-European basis.

The various measures include legislation on the harmonisation of insurance, mutual recognition of professional qualifications, common standards for construction products, opening up public procurement and harmonising product liability requirements. The possibility of taking steps to harmonise liability and contractual arrangements in the European construction industry is also being examined. These initiatives are described more fully at Annex C.

7.6 The Study Team's Assessment

The Team concluded that:

- the international comparisons outlined above indicate the relative rigour of the liability imposed on professionals under English Law. It is not that the individual elements of the English system are in every case the most rigorous but that the components—fault as currently adjudged by the courts, unlimited liability, limitation periods, joint liability and contribution—are severe in their combined effect;
- the practical arrangements in Denmark for restricting the liabilities of consultants to a just and equitable proportion of the damage are a useful model which should be given careful consideration;
- it is significant that the range of current concerns in this country about uncertainty and inequity follows, broadly speaking, a similar pattern in other countries, in particular Australia and New Zealand, with legal systems based on the English model;
- the European Commission may pursue possibilities for harmonising liability, insurance and indemnity arrangements in the Community. The difficulties of making progress, not least because of differences between the countries with a common law tradition and those with legal systems based on the Napoleonic code, should not be under-estimated. It is likely, however, that the French system of statutory decennial liability

insurance and 'dommage ouvrage' insurance will play a major part in the Commission's thinking; and

- all the participants in the construction process and the Government should give careful consideration to the merits of the French system.

References

- (1) Latent Defects in Buildings: Analysis of Insurance Possibilities, Atkins Planning, NEDO (1985).
- (2) International Council for Building Research Studies and Documentation (CIB), Working Commission W87, Post Construction Liability and Insurance.

SECTION 8

The Case for Action Now

8.1 Foreword

To some extent, the case for action depends upon the future demands on the construction industry. For the past two decades, the added value of the construction industry has contributed between 5.9 and 6.1 per cent of GDP. The motorway programme has grown, faded and is blossoming again, university and school building has blossomed and declined and, more recently, retail, commercial and industrial development have soared. In their 1985 forecast, Cambridge Econometrics postulated two scenarios; one with no change other than that arising from growth in GDP; the other assuming that environmental pressures for the renewal of the infrastructure will lead to a construction boom in the mid-to-late 1990s, with an estimated construction output growth of 2.8 per cent per annum to 1995 and an annual rate of 3.3 per cent thereafter. In the latter case, output would be roughly one third higher in 1995 than in 1985 and almost two thirds higher in 2000. Prospects for construction were judged to be better than for industry at large.

The prospects for growth must, however, be seen against a background where the active labour force will be virtually static and the number of school leavers falling. There is therefore likely to be a sustained effort to improve productivity. This is already taking place.

Construction management, performance requirements and control of accuracy are now better understood. Mechanisation has transformed civil engineering, groundworks and handling on building sites since the last productivity drive in the mid to late 1960s. Other changes include replacing general contractors by management contractors and sub-contractors, some with specialised design and assembly skills. Above ground level, major buildings are often assemblages of brought-in components. Scope for improvement is limited in some sectors; repairs, maintenance, refurbishment and conversion, now accounting for almost half the output, are on the whole obliged to use traditional techniques and materials. However,

even if construction output only keeps pace with GDP, the pressure for improved productivity will be relentless.

8.2 Prospects

Buoyant demand will call for adaptability, so that the industry can respond as specific construction sectors wax and wane, and for higher productivity to contain costs when competing for resources with other sectors of the economy. In general, the consequences of sustained demand are likely to be that:

- market forces will ensure clients are less able to impose onerous conditions;
- increased mechanisation, already far advanced in civil engineering and materials handling, will be made more worthwhile by higher prices and prospects of continuing demand. This will put a premium on buildability and favour contractors who assume more responsibility for design development;
- a major contribution to productivity will come from expanding the scope of component building;
- consultants will then concentrate on advice, preliminary design, system design, performance specifications, specifying and selecting components, and, possibly, project management;
- as component building expands, specialist sub-contractors and component manufacturers will gather greater responsibilities and liabilities; and
- the former distinction between roles will blur, with much advanced design knowledge and skills residing with contractors, sub-contractors and component manufacturers.

Change will be gradual. Professional liability will be lessened in some respects and increased in others. The reduced involvement in design development will protect consultants from some claims, but their contribution to projects will be more exacting and visible. Their liabilities may

be safeguarded by carefully drafted conditions of engagement and by prudent practice. From a client's standpoint, the arrangements outlined will be less certain than those that now obtain.

The Single European Market will bring opportunities and predators. Demand for construction will not be reduced should the UK construction industry be slow to respond. Materials and component manufacturers in the EC will have the incentive of operating in the Euro-market. Already the surge of construction output in the UK in recent years has drawn in supplies from far afield. Design and management abilities are highly transportable, and it is important that clients, the professions, and the industry are not hindered by ingrained defensive tactics, by uncertain liability and by uncertain routes to redress.

8.3 The Consequences of Inaction

The consequences of taking no action are likely to be that:

- except where experienced clients with continuing programmes create good relationships, mutual trust will be replaced by distrust to the detriment of clients' interests. This has already happened with building surveys for domestic clients;
- lack of trust and uncertain relationships will lead to more mounting, pursuing, avoiding and containing of claims and to more litigation;
- defensive tactics and risk transfer will become general practice. These may be helpful when they lead to a clear demarcation of responsibilities and to certain basic rules consistently applied. They are not constructive when they reduce the possibilities for collaboration, which is known to lead to better results and fewer mistakes;
- more claims and litigation will increase legal costs and the cost of settlements and awards;
- if fee income falls relative to workload, as fee negotiation and fee competition replace appointments on scale fees, PI premium rates related to fees will increase;
- inevitably, PI premiums will increase and become less affordable, unless consultants accept higher deductibles or lower limits of indemnity. Consultants will then be more at risk, with an even higher proportion of claims and

settlements being met from their pockets.

What would be particularly damaging is the continued erosion of trust, as defensive tactics and risk shedding replace collaboration. Too great a proportion of the time and effort of clients and the professions would be devoted to laying and evading traps and to devising and rebutting claims. This trend will be more difficult to reverse the longer it continues. It could blight the industry's response to the 1990s.

8.4 The Study Team's Assessment

The Team concluded that:

- to do nothing will perpetuate the current erosion of trust and confidence. This in turn will lead to defensive tactics and risk shedding becoming accepted practice, both impeding change and reducing efficiency and competitiveness; and
- the measures proposed in Section 10 should go a long way towards reversing the current trends, thereby helping the professions and their clients to make the adaptations needed to raise productivity in the 1990s and thus to respond to the opportunities presented both by a buoyant UK construction market and by the Single European Market.

SECTION 9

Priorities for Reform

9.1 Foreword

This section draws together the arguments and assessments of Sections 2 to 7 and reviews the possibilities for reform identified by the Study Team.

9.2 Interdependence: The Web of Liabilities

The Emerson⁽¹⁾ and Tavistock⁽²⁾ reports emphasised the interdependence of construction activities arising from the temporary coalitions of clients, consultants and contractors whose roles, responsibilities and liabilities change as projects progress. Behind them are specialists, sub-contractors, materials suppliers and manufacturers upon whom the quality of the building very largely depends. Clients' decisions are influenced by expectations of achievable quality, notions of value-for-money and likely cost. Designers respond to their clients' briefs, taking account of the opportunities and constraints of the procurement arrangements and of the expected performance of components, contractors and sub-contractors. In turn, all involved have to respond to the demands placed on them by the design. The construction team has also to accommodate changes imposed by clients.

The many specialists, contractors, sub-contractors and component suppliers normally negotiate different conditions or guarantees. One central London project engaged more than 100 sub-contractors and specialists, many of whom relied on sub-sub-contractors and labour-only operatives. Figure 9.1 indicates the complexity of this web of interrelated responsibilities and liabilities.

Design professionals are very vulnerable. They are normally involved from the inception of a project to its completion and are ordinarily engaged to inspect construction. They are a natural target. Since the *D and F Estates* case, clients are more likely to attempt to impose liabilities on their consultants which cannot effectively be discharged. The increased complexity of responsibility and liability is likely to result in litigation becoming more costly, more protracted and less predictable. Multi-party actions and the principles of joint liability and

contribution will aggravate the situation. Nevertheless, clients will still not have an assured route to redress.

Contractors offering design and construct services are also apprehensive about their liabilities. A major contract involves the appointment of many specialist sub-contractors, some with significant design responsibilities and most employing other sub-contractors. The task of obtaining comprehensive and effective 'back-to-back' agreements is practically unachievable. Many specialist suppliers insist upon their own standard terms and conditions and, with little effective competition, there is no alternative but to accept them. Moreover, few sub-contractors have the resources or insurance to meet a major claim. This is also a matter for concern for clients who expect to be protected.

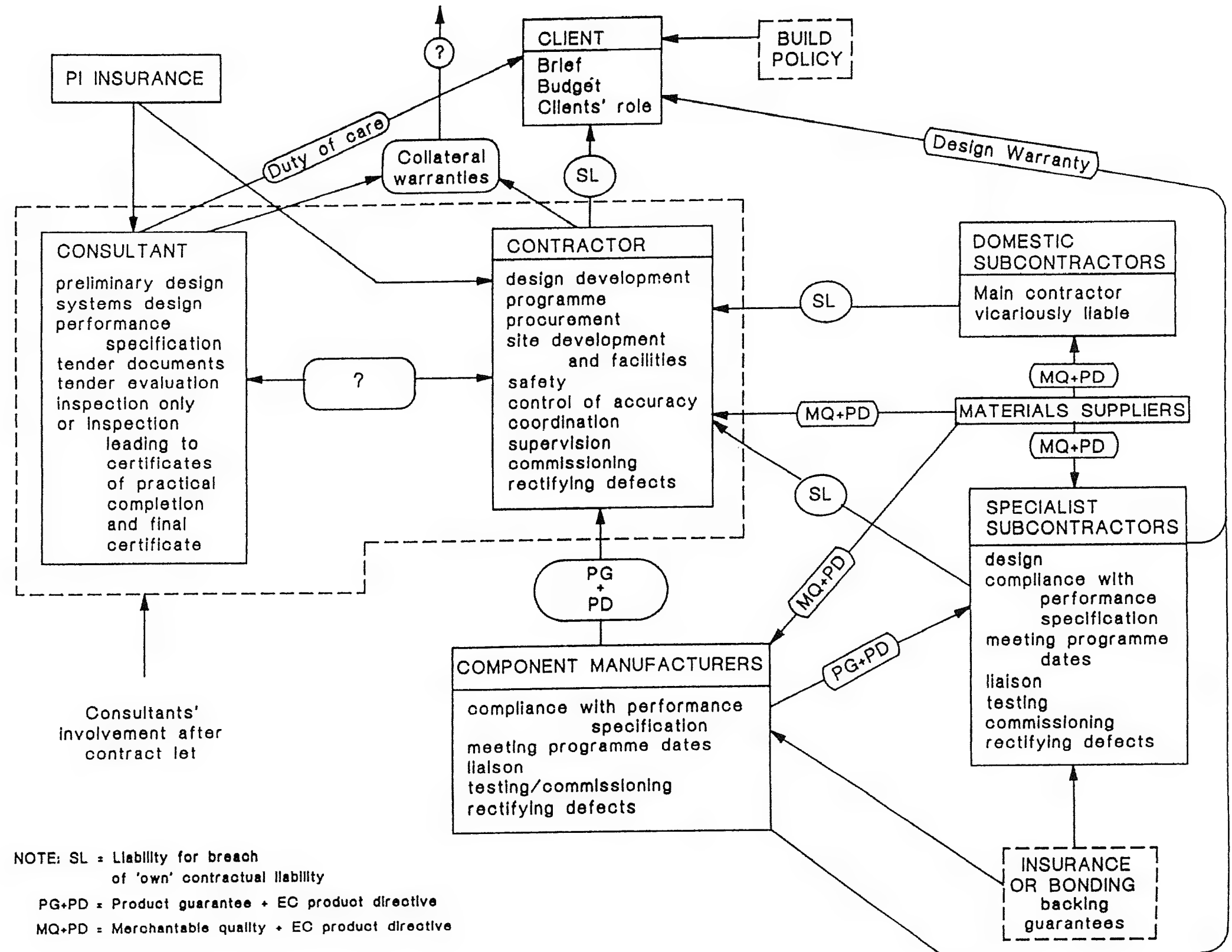
Interdependence also creates problems for civil engineering projects. In the main, they are more manageable because there are fewer participants. There is normally close liaison between a client's professional staff and the consultants. Contractors or their specialist sub-contractors are directly responsible for most of the construction works. They are, however, probably more exposed to the uncertainties of informed judgments.

9.3 A Comprehensive Solution

Some of the industry's developing practices and structural changes will reduce the interwoven relationships that now characterise construction—for example, when a contractor is responsible for design development, working method, site management and the labour force. Others will have the opposite effect—for example, when the principal designers are responsible only for preliminary and systems design and for performance specifications. Design responsibilities are then widely distributed amongst the main contractors, specialist sub-contractors and component manufacturers. Currently, consultants' liability is based on negligence and contractors are strictly liable for breaches of contract, whether their own or those of their domestic sub-contractors.



Figure 9.1



Component manufacturers normally offer guarantees, and suppliers are liable if materials are not of merchantable quality. Whilst defective components and goods are replaced to fulfil guarantees, consequential costs are obtained only with difficulty.

The responsibilities and liabilities of all involved in construction, including local authorities and others offering building regulation and inspection, would have to be taken into account in any comprehensive reform. A considerable amount of regulation, which would have to include mandatory insurance throughout the chain of sub-contractors and suppliers, would be required. Such an approach, in the Study Team's opinion, is not yet justified.

There are other more direct ways of improving quality and reliability of construction, in which the professional institutions and consultants' associations could play an important part. Some factors are outside the ambit of this study, although relevant to it. These include a 'minimum adequate' attitude towards quality, which has permeated standards, and the overtly short-term, cost-conscious approach to design. These are responses to a market dominated by demands for minimum first cost.

There are signs that attitudes are changing. Experienced clients, who participated in the interview survey, were committed to the success of their projects. Quality management and quality assured products and processes are demanded where they would not have been a few years ago. These requirements will become commonplace, providing clients recognise that improved and reliable quality has a first cost, well justified in the long term. If this is accepted as a better option than regulation, what reforms would help professionals better to make their contribution?

The Study Team's assessment is that the complex relationships, responsibilities and liabilities cannot be eliminated, but they could be made less critical and more manageable by reforms leading to greater clarity and certainty—that is to say, a scenario where risks are assigned to those who can best control them. This approach will be effective only if clients, consultants, and other participants give quality management and quality assurance high priority.

9.4 Policies Leading to the Recommendations

9.4.1 Quality Management

Quality management is at the heart of the proposed reforms. It is recommended that the

institutions play a more active and comprehensive role as part of their responsibilities for self-regulation. Almost certainly, this will entail expansion. Inevitably, consultants and ultimately their clients will have to meet the additional cost.

9.4.2 Clarity

Joint action by the institutions and associations would lessen some of the problems of interdependence and pave the way for a joint approach to other pervasive problems. The first and essential step is to define more clearly the responsibilities and liabilities in contract. Even professional services involving only one consultant give rise to frequent disputes about the scope of the service provided. Often the formal requirements of a brief and a negotiated commission are overtaken by events, as one task is added to another. Available funding or time may dictate the scope of an enquiry. With the passage of time, clients may believe that they were promised a degree of certainty which was not contemplated by the consultant. Moreover, with all the care in the world, informed judgments may be mistaken. Risks need to be stated and shared sensibly if opinions are not to be occluded by doubts or if over-design is to be avoided.

The greater the complexity of design and construction, the greater must be the care taken to align conditions of engagement with reality. Architects' conditions of engagement should make it clear that they will not design the structure, if that is to be done by an engineer, that they will not design the components, if that is to be done by suppliers, and that they will not design the services, if that is to be done by a combination of engineers and sub-contractors. If consultants do not wish to accept responsibility for inspection or supervision, they should say so; project managers can be employed for such purposes. Alternatively, supervision could be carried out by the contractor and a consultant's duties confined to checking the contractor's quality assurance and control schemes.

Current conditions of engagement do not reflect the realities of today's major projects, where consultants have neither the knowledge nor the technical and logistic means to undertake all elements of design. One solution would be to devise conditions of engagement to define the responsibility of all the professionals; this would have repercussions for clients and others.

At the same time, standard conditions of contract and revised conditions of engagement should be harmonised to clarify interrelated

responsibilities. Insufficient account is taken of post-contract co-ordination of specialist design with general design, which inevitably involves consultants in interdependent decisions, often hurried in order to meet construction programmes. Similarly, the complementary responsibilities for inspection and supervision need to be aligned so that the scope of these tasks is clear.

Professionals' liabilities in tort have lessened to a degree but there are many aspects where they can and should protect themselves. A general principle is that liability to the client in tort cannot exceed that in contract³. As regards liability in tort to those with whom they are not in contract, and disregarding liability for physical injury, the most likely area of liability is that which derives from the decision of the House of Lords in *Hedley Byrne*. Where a person makes a statement to others knowing that they will rely upon it, then, in certain circumstances, he or she is liable for economic loss suffered if the statement was made negligently. If, however, the professional makes it clear that his or her advice is "given without responsibility", the liability can be disclaimed.

9.4.3 *Certainty in law*

Almost all respondents to the review sought greater certainty in law and quicker and less costly litigation. Certainty in the law would also reduce the number of cases which turn on a point of law.

Predicting the results of litigation as it affects professionals has been peculiarly difficult during the last two decades. There are inherent difficulties which arise from the evidence which may be found and from the substantial changes in judge-made law relating to negligence. The work undertaken, an alleged failure of service, the service of a writ and the court hearing may each have occurred in a different climate. However, recent decisions of the court have restricted claims for damage actionable in tort, and plaintiffs pursuing actions in tort now have in general no greater advantage, save limitation, than were they to pursue the same action in contract. Clients and the industry can be more certain of their rights and liabilities in this regard. On the assumption that the current position will be maintained, no recommendation is made for legislation to codify relevant case law.

Clients, consultants and contractors alike argued for greater certainty in law so that their rights and liabilities would be clear. Litigants are now put to great expense and settlements are long delayed whilst issues of time limitation

are resolved, often at great cost. For the reasons explained in Section 5, there will be a significant improvement in certainty only if the Limitation Act 1980, as amended by the Latent Damage Act 1986, is amended to create a single absolute longstop from a deemed but verifiable date of accrual of the cause of action. Not only will claimants and defendants be more certain of their rights and liabilities but the length of time for which it is prudent to retain papers will be roughly halved.

The law is well established in that a successful plaintiff pursuing more than one defendant can obtain all his or her damages against any one liable defendant. Consultants are therefore vulnerable because they are expected to maintain PI insurance which is seen as being in place to protect their clients' risks, which it is not. Few other defendants offer clients the security of insurance and, once litigation commences, some seek the haven of liquidation. The effect is, therefore, to transfer liabilities post-hoc to consultants and perhaps to contractors. In the Study Team's view, this aspect of the law is one of the most important of the many issues put to the study. Apart from imposing unfair settlements, it positively invites those with claims against contractors, specialist sub-contractors or component manufacturers to join all the available consultants in the action.

The Study Team does not underestimate the difficulty of securing legislation to amend the law, which is embedded in general law. It therefore recommends that, as a first step, the professional institutions and consultants' associations should seek the agreement of clients' associations to limit the liability of consultants to their just and equitable share of blame and that this should be embodied in the revised and unified conditions of engagement. Such a concordat exists in Denmark and is said to work well.

9.4.4 *Certainty in Litigation*

Litigation is often a continuation of negotiation, illustrated by the number of cases withdrawn or settled before hearing. Once writs are served, the major uncertainties are the outcome and the time and costs needed to achieve a settlement or award. Facts to be found do not necessarily determine the outcome. Commercial considerations and bargaining strength also play a major part.

Costs incurred are comparatively small in the early stages of litigation. Much depends on the skill of lawyers. Some kind of expert view is usually required at an early stage but a preliminary and not too costly report is often

sufficient to advise the client whether litigation should be avoided or pursued. Subsequently, costs mount very rapidly. With multi-party actions, negotiated settlements are long delayed until all the parties are convinced that their best interests are served by a settlement, and the defendants are able to agree upon the amount of their respective shares of the settlement. Parties in an action with only minor responsibility are effectively barred from buying their way out by means of a payment into court at an early stage, because a payment is only effective if it is sufficient for the whole of the plaintiff's claim.

Despite near unanimity amongst respondents that litigation is too slow and too costly, the Study Team is not convinced that a case has been made for any extraordinary measures. The recommendations of this report would settle some of the important uncertainties in law, reduce the number of defendants swept into multi-party actions, increase certainty and provide an alternative to litigation for smaller claims.

One common assertion is that it is too easy to make a claim. The right to make claims could not be easily curtailed, although it often imposes unnecessary and unproductive costs on recipients. If litigants want cheaper, quicker resolution of disputes, they will have to accept cruder and somewhat less searching procedures. For example, much of the world does not have discovery and in international arbitrations it is common to limit strictly the amount of time available for witnesses and submissions. Alternative disputes resolution procedures could have an important role but the Study Team does not believe that they should be forced on litigants, with one exception. Almost half the writs registered in the Official Referees Court settle for less than £25,000. Claims for less than, say, £50,000 ought to be within the competence of a short procedure arbitration decided on a papers-only basis. The institutions should devise a procedure to form part of the revised conditions of engagement.

9.4.5 *Certainty of Redress*

Important amongst the issues of professional liability are claims arising from injury and death. Currently, the protracted legal process and often long delays before compensation is paid are distressing to the victims. Also, the fact that compensation turns on proof of fault is believed to colour judicial assessments, sometimes to the disadvantage of construction professionals. From the victims' standpoint, compensation should be available following proof of loss or damage and should be separated from

the process of allocating blame. The problem to be resolved affects many parties other than construction professionals, including the owners and occupiers of buildings and installations of all kinds, and falls outside the Study Team's terms of reference. It should not, however, be left to fester.

Prudent clients safeguard their interests in many ways. Parties to the contract may be required to provide bonding, to insure their liabilities or to provide collateral warranties. All these requirements have the disadvantage that they rely either on the parties having a continuing existence or on insurance which will not have been negotiated by clients and which, therefore, may not adequately protect their interests.

Clients with continuous construction programmes use their experience and the prospect of further commissions to negotiate settlements with consultants. These negotiated settlements cope effectively with all but major failures. For these clients, PI insurance is catastrophe insurance. If a negotiated settlement is not possible, fault has to be demonstrated and is usually contested. PI insurance is a very indirect and inefficient way of protecting clients' interests.

Certain redress for latent defects is afforded by the French decennial system based on statutory duties for clients, contractors and consultants. The Team has been assured that the system is now working effectively after severe initial troubles in the 1970s and is impressed by its clarity and comprehensiveness. In the meantime, NEDO's BUILD report provides a starting point, although it is currently limited in the extent of its cover. Clients who cannot accept the risk of being unable to obtain redress should insure their own risks by material damage insurance such as BUILD. The Study Team notes and commends the active interest of major developers in BUILD.

9.4.6 *Risk Sharing*

Clients, consultants and the industry all benefit from arrangements that manage risks efficiently, are certain and provide equitable redress. Most clients accept that some risks properly accrue to them. The clarity advocated would give clients and their consultants more confidence in the way risks are assigned, with less opportunity for misunderstandings, genuine or otherwise. Inevitably, the arrangements have to be sufficiently robust to cope with less than good practice, incompetence, mistakes and other sources of error, with the law providing the means to contain and resolve

disputes, and insurance the guarantee that the legal liabilities of the consultants will be met.

The case for legislation to limit the liability of construction professionals was considered. However, an attempt to legislate in the interests of this group of professions would open the case for limited liability, for all providers of services. This is not to reject the reasonableness of limiting liability, which is accepted and endorsed. It would remove the spectre of extinction, make PI premiums more affordable and the professions less apprehensive. It is, of course, always open for clients and consultants to agree on limitations on liability in contract. Schedules of reasonable limitations on liability, agreed by the respective institutions, associations and clients could be incorporated in the revised conditions of engagement. Actual limits on liability would be a matter for negotiation, commission by commission. It would be possible for actions in tort to be brought despite limitations of liability agreed in contract, but recent developments in the law would seem to make this less likely. The Study Team believes that the benefits will be found to be worthwhile and that this experience could help to demonstrate the fairness and practicability of legislation to limit professional liability.

References

- (1) Sir Harold Emerson, Survey of the Problems before the Construction Industry.
- (2) Higgin G and Jessop N, Communications in the Building Industry, Tavistock Publications (1965), section 3, paragraph 41 *et seq.*
- (3) *William Hill Ltd v Bernard Sunley & Sons* (1982) 22 BLR 1(CA).

The Study Team's Recommendations

10.1 Foreword

The Study Team's findings are that:

- the objectives of improved quality and risk management and clarity of responsibilities and liabilities can be pursued immediately through initiatives by the institutions and associations, representing clients, professions and insurers;
- greater certainty can only be achieved by amending the law of limitation;
- the way the law operates regarding joint liability and contribution makes the professions prime targets in multi-party actions, which can result in professionals and their insurers paying for the faults of others;
- a comprehensive solution to the problems of the liability of construction professionals would entail statutorily limited professional liability, mandatory insurance and an agreed basis for risk sharing. The findings of the review do not justify this for the construction industry alone; the services of other professions for their clients would also have to be taken into account. This would be better referred to the Law Commission.

The Study Team's recommendations are in two groups; those directed to the Government and those directed in the main to the professions and their clients. These recommendations pay particular regard to the special needs of occasional and domestic clients, who are less able to safeguard their interests than are corporate clients who place continuous demands on the professions. Although not strictly within the terms of reference, account has been taken of contractors' increasing design role. The recommendations should be relevant to them.

10.2 Recommendations Addressed to Government

10.2.1 Time Limitations

The Study Team recommends that serious consideration be given to alterations in the law

to make time limitation on liability certain. This proposal is supported by all the institutions and associations and by the British Property Federation.

The proposal is to amend, in English law, the Limitation Act 1980 and thus the provisions introduced into the 1980 Act by the Latent Damage Act 1986, and, in Scotland, the Prescription and Limitation (Scotland) Act 1973, to achieve the following:

- a limitation (prescriptive in Scotland) period of ten years from the date of practical completion or effective occupation (staged if necessary), for negligent actions in tort (delict in Scotland) and in contract (whether or not under seal);
- the ten years limitation period acting as a longstop extinguishing the right;
- redefinition of the term 'deliberate concealment' so that ordinary construction processes would not lead to an exception to the longstop.

These statutory provisions, although part of general law, are crucial to construction litigation because of the importance of latent defects. The principle of a decennial limitation period is already part of English statute law. This was established by the Consumer Protection Act 1987 which itself was a consequence of EC harmonisation. If Ministers accept this recommendation, amending legislation could be deferred until negotiations preparing for completion of the Single European Market are well advanced, since these themselves may lead to legislation which would affect liability in the construction industry.

Consideration might also be given to shortening the period allowed for launching contribution proceedings because this imposes further costs on all the parties involved.

These recommendations would remove the current differences between the limitation periods and dates of accrual of the cause of action in contract and tort and also the distinction between contracts under hand and under

seal (probative and improbative contracts in Scotland). Both clients and consultants would benefit from the removal of one of the principal causes of uncertainty in litigation. The other effects should be even-handed. Clients would benefit from the longer limitation period when contracts would have been under hand and lose when they would have been under seal. Conversely, the professions would lose when contracts would have been under hand and gain when they would have been under seal. The effects of the proposed alterations to the liability periods of action in tort would depend on circumstances. For example, clients would probably gain if the breach (for longstop limitation) occurred early in a major project and lose if the reasonable discovery of damage approached the 15 years longstop (or in Scotland the long negative prescriptive period of 20 years).

10.2.2 Joint Liability

The Study Team recommends that serious consideration be given to the alteration of the law in commercial transactions, not involving personal injury, where the plaintiff's claim exceeds, say, £50,000. In such cases, a defendant whose actions are partly the cause of damage to the plaintiff, but such actions were not carried out jointly with another defendant, should be responsible to the plaintiff only for damages equivalent to that part of the plaintiff's loss fairly attributable to his or her breach.

For reported cases which illustrate the present operation of the principle of joint liability and a liability which is not confined to that of joint tortfeasors, attention is drawn to, for example, *IBA v EMI* (1980) 14 BLR 1 A; *Hutchinson v Norman & Dawbarn* (1986) Construction Law Journal 180; *London Borough of Merton v Lowe* (1981) 18 BLR 130 145; and *Devlin J in Heskell v Continental Express Ltd* (1950) 1 ALL ER 1033 1048.

This recommendation is strongly supported by the professional institutions and consultants' associations. The British Property Federation accepts that the current law can be unfair to consultants. Clearly, this recommendation raises issues of public policy and may be relevant to other professional services which may need to be considered by the Law Commission. However, it is of particular importance to the construction professions because of the likelihood of their being joined in actions in which potential defendants may no longer be in business or other defendants may quickly liquidate.

10.3 Recommendations Addressed to Professional Institutions and to Clients' and Consultants' Associations

The Study Team recommends that the professional institutions and the clients' and consultants' associations:

- commission and keep under review clients' guides, focused on identifiable groups of clients, to help them fulfil the clients' role;
- commission combined conditions of engagement each related to the principal appointments likely to be made for typical services and projects, including identification of a clients' role;
- devise standard collateral warranties, extending current professional liability only to 'immediate' third parties and in terms acceptable to PI insurers;
- review the better alignment of consultants' conditions of engagement and the standard conditions of contract, with the particular objectives of:
 - giving effect to the recommendation that tender documents should require contractors to state their intended quality management regime;
 - providing for better post-contract coordination, especially the coordination of the design proposals of specialist sub-contractors with each other and with the design of the project;
 - aligning the many collateral warranties now demanded of the various parties and the extent to which these are backed by parent company guarantees, bonding or insurance.

10.4 Recommendations Addressed to Professional Institutions and to Consultants' Associations

The Study Team recommends that professional institutions and consultants' associations:

- establish a 'short procedure' arbitration serving clients, especially domestic clients, of the construction professions. This could be of material assistance to plaintiffs and defendants. An undertaking to refer disputes where the sum claimed is less than, say, £50,000 to 'short procedure' arbitration might be incorporated in the revised conditions of engagement;

- review arrangements for regulating the standards of professional competence of members in order to ensure that these are sufficiently rigorous and transparent to satisfy consumer and professional interests in a vigorous commercial climate;
- consider the feasibility and advantage of imposing mandatory PI insurance on sole practitioners and all practices;
- examine the option of practising as a limited liability company as an effective operational mode for consultants;
- consult with client bodies about the possibility of devising guidelines for limiting the liability of professionals with the consent of their clients for individual commissions;
- consult with client bodies about the possibility of a concordat which would limit the liability of a consultant to his or her client to a just and equitable proportion of the damage suffered where there is more than one defendant whose actions were not carried out jointly;
- review the range of services offered to members. In addition to normal learned society functions, they should cover:
 - the administration of practising certificates;
 - issuing good practice advice; and
 - issuing risk management advice, which might include:
 - a tecalert service;
 - quality management and certification guidance notes appropriate to sole practitioners and to consultancies of various sizes; and
 - risk management guidance notes, including appropriate arrangements for limited liability as one aspect of overt risk sharing.
- explore ways to fund this range of services, including charging self-financing fees, perhaps on a subscription basis, practice subscriptions (in addition to members' subscriptions) and offering all or some of these services as joint ventures in collaboration with other institutions or associations.

10.5 Recommendations Addressed to Insurers and Brokers

The Study Team recommends that insurers and brokers:

- devise a code of practice for PI insurance which should be the subject of consultation with professional institutions and consultants' associations;
- devise methods for monitoring and analysing trends in claims notifications in order to generate risk management advice and identify research topics;
- devise better run-off provisions for retired partners;
- introduce BUILD insurance.

10.6 Further Observations

The Study Team touched on some wider issues, in particular liability arising from personal injury claims. The Team concluded that this poses such fundamental questions that it could be resolved only as part of a review with much wider terms of reference.

The Study Team's recommendations, bound by the terms of reference, concern only the professional liability of the construction professions. Extensive though this subject is, it is only part of the complex issues arising from the interdependence of construction processes and from the unique characteristics of construction projects. Trust, good practice and co-operation can contain these problems, as is demonstrated by the good practice reported in this review.

However, not all clients are good clients and not all consultants are competent and diligent. Their performance and responsibilities are often judged in hindsight. The law, if it is to contain and determine disputes efficiently, needs to be certain. Insurance needs to relate to the risks of the insured. The Team's recommendations, the minimum that will suffice, set out to create that certainty in law, professional practice and insurance essential both to clients and the professions.

Terms of Reference for Fact-finding Studies

In the light of current concern about the cost and availability of PI insurance and the extent of professional civil liability for negligence, to establish the facts about the effect on the following professions of the way the law operates in providing remedies to those who suffer loss as a result of the way in which a professional person performs his duties:

- (a) auditors (and other accountants in independent public accounting practice who carry out reporting functions arising out of statutory requirements);
- (b) architects/consulting engineers/construction surveyors; and
- (c) other surveyors (such as land surveyors and mining surveyors).

The studies should in particular:

- (i) examine the nature of the service provided by the professions listed above; the professional duties and liabilities arising from that service, including the extent to which there are requirements to conform to professional standards and guidelines; the way in which the service is held out to the public; and public expectations and understanding of the service provided;
- (ii) obtain detailed information about recent trends in the availability and cost of PI insurance for the professions listed above, and the reasons for these;
- (iii) obtain information above how the law has operated in the past and how it currently operates in relation to actions in negligence against members of the professions listed above;
- (iv) consider international developments, with particular reference to the European Community, and the extent to which they have affected or may affect (i), (ii) and (iii) above;
- (v) assess the effects, now and in the future, of (i), (ii) and (iii) above on the availability, quality and cost of the services provided by the professions listed above and the impact on those who rely on the service provided by members of the professions, and to assess the effects of (i), (ii) and (iii) above on the effectiveness and competitiveness of these professions; and
- (vi) if appropriate, suggest possible next steps in future consideration of the subject.

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Leo Barros D'Sa—Property Services Agency.

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Gail Marshall (until September 1988)—Department of the Environment.

Gerry Shevlin—Department of the Environment.

Note:

Members of the Study Team served in a personal, not a representative capacity. The participation of individuals should not be taken as necessarily implying acceptance of the report by their respective organisations.

Acknowledgements

During the course of the review, the Study Team took evidence from well over 300 individuals, representing themselves, firms, institutions and associations. The Team wishes to thank all those who gave so generously of their time and expertise. They are acknowledged in the lists below.

The Team's particular thanks go to:

Jenny Baster, Legal Adviser to Ove Arup Partnership, who provided invaluable advice on legal issues and assisted in drafting key sections of the report.

Peter Madge, Willis Wrightson Ltd, who provided a comparative international study of liability and insurance arrangements.

John Uff and Phillip Capper, Centre of Construction Law and Project Management, King's College, London, who provided a report on the current legal position regarding liability in construction; Phillip Capper also condensed the report into Annex B and assisted in drafting Section 5.

Graham Wacholder, South East Regional Office (DOE), who carried out a study of arbitration mechanisms and alternative dispute resolution.

1. Institutions and Associations

- Architects Registration Council of the UK
- American Consulting Engineers' Council
- American Institute of Architects
- American Society of Civil Engineers
- Association of British Insurers
- Association of Construction Arbitrators
- Association of Consulting Architects
- Association of Consulting Engineers
- Association of Consulting Engineers (Australia)
- Association of Consulting Engineers (New Zealand)
- Association of County Councils
- Association of District Councils
- Association of Project Managers
- British Institute of Architectural Technicians
- British Property Federation
- British Quality Association
- Building Employers Confederation
- Chartered Institute of Arbitrators
- Chartered Institute of Building
- Chartered Institution of Building Services Engineers
- Confederation of the Associations of Specialist Engineering Contractors
- Construction Industry Research and Information Association
- Faculty of Advocates (Scotland)
- Faculty of Building
- Federation Internationale des Ingenieurs - Conseils
- Federation of Civil Engineering Contractors
- Institute of Chartered Accountants
- Institution of Chemical Engineers
- Institution of Civil Engineers
- Institution of Clerk of Works

Institution of Electrical Engineers
Institution of Mechanical Engineers
Institution of Structural Engineers
International Bar Association
Law Society
National Contractors Group of the Building Employers Confederation
New Zealand Institute of Architects
Royal Australian Institute of Architects
Royal Incorporation of Architects in Scotland
Royal Institute of British Architects
Royal Institution of Chartered Surveyors
Scottish Building Employers Federation
Scottish Law Commission
Society of Chief Architects of Local Authorities

2. Companies & Partnerships

ACER Group
Bain Clarkson
Baker and McKenzie
John Barber
Beale and Company
Bickerdike Allen Partners
Alfred Blackmore and Company
Briffa and Phillips
J Alan Bristow and Partner
British Airports Services Ltd
Building Design Partnership
Burmah Castrol
Burrell, Hayward and Budd
Campbell Reith and Hill
D T Cary and others
The Centre for Construction Market Information Ltd
Chapman Taylor Partners
Brian Colquhoun and Partners
Davies Arnold and Cooper
Davis Langdon and Everest
Denton, Hall, Burgin and Warrens
Excess Insurance Company
Felix Samuely and Partners
Foster Associates
Frank Graham and Partners
Gardiner Roberts and others
Grand Metropolitan Estates
Greycoat Group plc
Griffiths and Armour
Hammerson Group
Harris and Sutherland
Higgs and Hill plc
Howard, Killick, Partridge and Amis
Hunter and Partners
Ingledew Botterell
The John Lewis Partnership
Langdon and Evert
Lloyds Bank plc
London and Paris Property Group
Marks and Spencer plc
Martin Grant Homes
Masons
McClure, Naismith
Melvin, Lansley and Mark

MEPC
Mott-McDonald Group
Municipal Mutual Insurance Ltd
Musgrave Development
Oscar Faber PLC
Ove Arup Partnership
John Pelling and Partners
Peter Brett Associates
Rendel Palmer and Tritton
RIBA Indemnity Research Ltd
RICS Insurance Services Ltd
Roundsworth Trust
Row and Maw
Rumball and Sedgwick
Rush and Tompkins
J Sainsbury plc
R Seifert & Partners
Donald Smith, Seymour and Rooley
Speyhawk
St Anselm Development Co
Stimpson Lock and Vince
Store House Group
Sun Alliance Insurance Group
Tarmac Construction Ltd
Thistle Hotel Group
Travers Morgan and Partners
Whitfield Partners
William Sindel plc
Wimpey Construction
The WREN Insurance Association Limited

3. Public Sector Bodies

Anglian Water Authority
British Standards Institution
Building Research Establishment
City of London Corporation
Colchester Borough Council
The Council for the Care of Churches
Department of Health
Department of Trade and Industry
Department of Transport
Grampian Regional Council
The Housing Corporation
Hove Borough Council
London Regional Transport
Lord Chancellor's Department
Merseyside Task Force (DOE)
NEDO Construction Industry Sector Group (Committee for CAD Data and Other Information
Exchange in the Building Industry)
National House Building Council
Northern Regional Health Authority
Northern Regional Office (DOE)
Official Referees Court
Office of Fair Trading
Property Services Agency
Scottish Office
The Water Authorities Association
West Midlands Regional Office (DOE)
Westminster City Council

4. Individuals

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Sir Michael Ogden QC
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Dick van Werven
Rhona Wyles

5. All those who attended regional meetings in Edinburgh, Birmingham, Liverpool and Newcastle and those who attended specialist meetings of construction lawyers, arbitrators, academics and expert witnesses.

Although the Study Team has benefitted greatly from the advice and information provided by all those who gave evidence, the responsibility for the conclusions reached rests solely with the Study Team itself.

Glossary

This glossary follows, with modifications, the one included in the BUILD report (NEDO, 1988).

PARTICIPANTS

Clients	In addition to successive owners who were not the developers, tenants are also included under this definition.
Developers	All who initiate and bring to fruition building projects, whether private sector developers, owners building on their own account or public sector organisations.
Insurance	Brokers, insurance companies, Lloyds, reinsurers, loss adjusters.
Producers	A conglomerate team embracing designers, other professional consultants, main contractors and subcontractors and in certain circumstances regulatory authorities under Building Regulations, but not including manufacturers and suppliers of building materials and components.

INSURANCE

Capacity	The maximum limit which the insurance market in its widest sense (ie including re-insurance) can accommodate.
Contractors' 'all risks' insurance	A material damage policy which protects the contractor and employer against loss and damage to the contract works during erection and until completed.
Damage	See 'Defect' below.
Deductible	The first amount of the claim not covered, sometimes referred to as 'excess'; for example, if a claim is for £1,000 and the deductible is £100, the insurer will pay £900.
Defect	In this report, 'defect' is generally used as a portmanteau term covering both 'defect' and 'damage'. In practice, they are different. Following the Atkins report, 'defect' is the cause, ie some shortcoming in the original construction, and 'damage' some physical manifestation. In practice, not all defects cause damage and not all damages arises from defects. See also 'Latent Defect' below.
Latent Defect	A latent defect is one which exists in the form of a deficiency in the product (for example, foundations which are too shallow) but has not yet caused or turned into damage to the product (for example, cracks in the superstructure). Latent defects are not usually discoverable until they produce damage and thereby become patent. Material damage policies may include more specific definitions in order to avoid dispute.
Professional Indemnity Insurance	A policy which protects the insured against his or her legal liability to pay compensation or damages to a third party and the costs of defence.
Material damage insurance	A policy which protects the insured against damage to his or her own property or that for which he or she is responsible, for example, a tenant insuring buildings.

LEGAL

Collateral warranty	A contractual promise (for example, that reasonable care has been taken or that a design will be fit for its purpose), typically given to a funder or a tenant, which is expressed in a deed, agreement or other document (such as a letter) and which is collateral to the other contract(s) between the various parties involved in the works.
Damages	Money recoverable in law as compensation for loss or injury.
Duty of care	The legal duty to take reasonable care to avoid acts or omissions which are likely to injure those to whom the duty is owed. Breach of this duty results in liability for negligence.
Negligence	Breach of a duty to take reasonable care.
No-fault compensation	Compensation which is available without need to prove fault.
Settlement	An agreement between the parties to a legal action, whereby the plaintiff drops the action, usually in return for a sum of money paid by the defendant.
Strict Liability	Legal liability which exists irrespective of fault on the part of the person made liable.
Subrogation	The right of a person who pays compensation to exercise rights of action against a third party which were available to the person compensated.
Tort	A wrongful act or omission independent of contract, in respect of which damages may be awarded.

Report of the Surveyors Study Team

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SECTION 1

Introduction

Terms of Reference

1.1 On 11 May 1988 the Secretary of State for Trade and Industry, Lord Young, announced the appointment of three independent Study Teams with similar Terms of Reference (Annexe I) to carry out fact-finding studies into the professional liability problems of selected professions: auditors; architects/consulting engineers/construction surveyors; and other surveyors. Membership of this Surveyors Study Team, and its Secretariat provided by the Department of the Environment, is at Annexe II.

1.2 We were asked to establish the nature, scope, extent and implications of the liability problems being faced today by surveyors (other than quantity surveyors and those professional men and women specialising in the construction industry). To implement our Terms of Reference we needed to examine the nature of the professional service provided; to examine public expectations and understanding of that service; to obtain information about the availability and cost of professional indemnity insurance; to ascertain information about how the law operates in relation to actions in negligence; to consider the international and particularly the EC aspects, to assess the implications for availability, quality and cost of the services provided; and, if appropriate, to suggest possible next steps for future consideration of the subject.

Scope of the Profession

1.3 Outside the construction industry the surveyor can be engaged in any one or more of a number of activities. These include: agricultural holdings, antiques, arbitrations, building surveys, taxation, mining, estate agency, planning, rating, maintenance, lettings, auctioneering, sporting rights, hydrographic surveys, property development, rent review negotiations and capital valuations for various other purposes.

Matters Outside Our Terms of Reference

1.4 In view of our extensive remit and limited resources and timetable for reporting, we decided to exclude all the professional liability

issues facing surveyors in the public sector from our Study. We note that the Law Reform Committee in their 24th Report on Latent Damage recognised that the question of professional indemnity was outside their remit but considered it to be desirable that the question of professional indemnity for surveyors—regardless of whether they are working in the public or private sectors, should be considered by an appropriately qualified body at some future date. We too consider it to be desirable that all the professional liability issues facing surveyors and other professionals in the public sector should be the subject of a special study.

Consultations Carried Out by the Study Team

1.5 Following statements by Ministers recorded in two DTI Press Notices on 28 October 1987 and 11 May 1988, the Study Team was set up to begin its task. On 11 October 1988 further information about the purpose of our particular Study Review was set out in a DOE Press Notice (see Annexe III) and contributions invited specifically from the profession and from any member of the public who wished to comment, either as a consumer or more generally.

1.6 More than sixty outside bodies were invited to submit views to the Study Team. In addition we held meetings with interested organisations; including the Consumer Association, the National Consumers' Council, the Building Societies Association, the Royal Institution of Chartered Surveyors, and the Society of Fine Art Auctioneers. We also held regional discussions in Leeds, Plymouth and Chester and issued separate Questionnaires to 942 consumers—eg members of the public and companies, and to 441 professionals. We are grateful to all those who responded to the Questionnaires, and to those organisations and individuals who have contributed to the Study and are listed at Annexe IV.

1.7 The Study Team wishes to record that it has greatly appreciated all the assistance received during this Study.

Framework of the Report

1.8 This Report follows through the terms of reference. It examines: the nature of the professional service; the issues of concern; the consumer considerations; the legal background; recent movements in the indemnity insurance market; and international aspects; our conclusions and recommendations and finally some implications for the future, and the possible next steps.

Relevance of the Study

1.9 The Study was set up in the light of concern about the professional indemnity issues confronting surveyors in the eighties, and the associated concern over the implications for the consumer. At the outset of this Study, it seemed that the main problem might be the magnitude of the total amount paid out as the number of claims rose, against the background of large increases in insurance premiums and a greater vulnerability of professionals. Professional indemnity (PI) insurance premiums are not rising as rapidly now as in the mid-80s (see para 6.10), but there are still matters causing anxiety to both the professional and the consumer which need to be addressed. The potential liabilities of surveyors have been highlighted by the publicity given to the House of Lords decisions in April 1989 (see para 5.18(e)). Moreover indemnity insurance is cyclical; the current trough of the insurance cycle provides an opportunity to examine what is happening now before the difficulties which are possible over the level of insurance premiums arrive in the early nineties. Professional Indemnity insurance considerations could have a profound effect on the quality and availability of surveying services in the next decade. Furthermore the problems identified in this report might be exacerbated by other factors including the growth of American-style litigation, a shortage of qualified professionals, and so on.

SECTION 2

Nature of the Service Provided

2.1 The Study Team, through its members, has had first hand knowledge of the main professional bodies covering the activities relevant to this Report and on which we have been able to draw. We also consulted other major interests and 'minority interest' groups (see Annexe IV) to ensure that all aspects of the work of the surveyors being considered has been taken into account.

2.2 The principal categories of the work undertaken by surveyors are set out below. The general function of a surveyor is to advise and act for clients in all matters arising from the ownership or use of land and buildings and other assets, a function which goes well beyond valuation and surveying *per se*. Nevertheless, the majority of negligence cases (some 60 per cent) involving surveyors covered by this review relate to valuations and surveys of residential property (see para 3.6).

Categories of Surveying Activities (Commercial and Residential) Considered

Estate Agency
Mortgage Valuation
House/flat buyers Report/Survey
Structural Survey
Property Valuation
Valuation for Rating Purposes
Landlord and Tenant
Management
Financial and Funding Advice
Development Consultancy
Mortgage Advice
Planning Consultancy
Auctioneering
Land Agency
Agricultural Estate Management

Valuations and Surveys

2.3 Given the evident public confusion about the difference between valuations and surveys (see para 4.18) the Study Team has looked carefully at what is involved:

A **Valuation** is *not* a survey. It is simply an assessment following an inspection by a qualified valuer of what the property is worth

on the open market. It is required by a lending body to assess whether the value of property being purchased provides adequate security for the amount being borrowed ie the mortgage.

A **Survey** is carried out by a qualified surveyor and is based on a detailed inspection of the state of repair and condition of the property. It usually takes the form of:

either:

a **house-buyers' report**: which is *not* a detailed structural survey, but a point by point assessment of all those parts of the property that are readily seen or reached and which have been inspected, together with an opinion of its market value. Attention will usually be drawn to the advisability of engaging specialists to report upon particular/potential problems noted.

or:

a **structural survey**—based on a very detailed and technical examination, it provides a comprehensive report on the condition of the property, and lists repairs, improvements and renovations considered necessary, and may provide an opinion of its market value.

Standards and Guidance Notes

2.4 There is no reason to doubt that surveying services are provided by people aiming to achieve high standards. However, the standards cannot be absolute because totally objective tests cannot usually be applied. The requisite skill and care may be present, but the product is often a matter of judgement and cannot be measured by scientific method. Seen in this light objective surveying 'standards' become impossible to frame. What is possible is: the identification of suitable methods of approach to a task; a set of guidelines; a check list. The RICS has so far only succeeded in setting up one set of detailed guidelines—for the valuation of property assets; these guidelines are also used by members of the Incorporated Society of Valuers and Auctioneers (ISVA).

2.5 These guidelines are kept under review by the Assets Valuation Standards Committee (AVSC) who monitor their use through the published details of company reports and accounts, takeovers, mergers and flotations. The guidance notes, however, do not provide the answer for a valuer, but only indicate the steps he might take. The AVSC guidelines are intended to protect the public, but, enforcement of any kind by the RICS is difficult. The general extension of guidance in the form so carefully worked out by the AVSC to all surveying activities would be impracticable and involve more resources than are available to the professional bodies.

2.6 The types of work undertaken by surveyors vary greatly; each activity carries its own risk factors which are assessed for indemnity insurance purposes on the claims experience for that particular activity. For example, estate agency work carries a much lower risk factor than surveying, valuation or property management. Those in turn attract a lower insurance rating than design, supervision, and project management.

2.7 Following one case alone, *Yianni -v- Edwin Evans & Sons* decided in 1981, the number of claims concerning mortgage valuations has risen considerably (see paras 3.6 and 5.18). It is estimated that in 1977 valuations probably represented some 5 per cent of the number of notifications ie claims notified by surveyors to their insurers, and about 21 per cent of the value of claims; by 1984 this had risen to some 26 per cent of the number of notifications and about 45 per cent of the value of claims.

2.8 The Study Team has considered the issues connected with the standard and quality of surveying services provided, the public's demand for guarantees, and the expectation of perfection. The public expect the professional to be right, not just careful. It is thought that the present use of the AVSC guidance notes, which can actually be monitored even though they lack a statutory basis for enforcement by the Courts, probably go as far as is practicable. This is particularly true since none of the bodies to which the practitioners covered by this review might belong, have statutory authority. Against that background the Study Team has considered what benefits might be enjoyed through the current move towards Quality Assurance (see paras 4.16 and 4.17).

SECTION 3

The Issues of Concern

3.1 The problem of professional liability and indemnity issues facing the professional and affecting the consumer, on which this Report focuses, has many ramifications. To assess its magnitude we studied figures supplied by RICS Insurance Services Limited (RICSIS). Looked at from the total number of surveying jobs carried out in a year, the average claim overall which is settled by insurers through RICSIS is small and the number of claims is very small—less than one per cent of all jobs undertaken. But that figure is increasing.

3.2 The total cost of claims, therefore, is not large. But although the figures involved are small, it is clear that they give rise to a real and serious concern largely perceived by the professional across all the various surveying activities, particularly those concerning the individual consumer and the residential property market. The individual consumer is directly involved in the majority of small claims in connection with residential property. For residential valuations and surveys the average claim settled in 1987 was about £3,500 (but that year of account has not yet been closed). For commercial property the incidence of claims is lower, although when the rare claim is settled the amount involved may be substantial.

Main Issues of Concern

3.3 The principal issues of concern are:

- (i) the public and the professionals are often at cross-purposes over the nature of the services provided;
- (ii) insurance premiums have increased due to the increase in claims;
- (iii) the members of the profession feel increasingly vulnerable to claims.

3.4 The problem of exposure of the surveying profession to civil liability is increasing; this is worrying and raises issues concerning the public interest. Details of the residential valuation claims in para 3.6, provided by RICSIS clearly demonstrate the sharp rise in claims in the first half of the eighties.

RICS Insurance Services Ltd (RICSIS)

3.5 Since 1976 RICSIS have arranged at least some part of the professional indemnity insurance for approximately half the surveying profession. They have shown that in 1977 the number of claims notified to insurers was approximately 1 for every 4 firms insured. By 1986 this had increased to 1 for every 1.6 firms insured. The amount paid in respect of residential survey and valuation claims by the RICSIS Insurers rose in the same period from approximately £500,000 to an amount in excess of £3,500,000 in 1986. In addition there were claims dealt with by the surveyors themselves, either because of uninsured excess or in respect of claims not notified to the insurers. It is estimated that the total cost of claims to the profession could be well in excess of £12,000,000 pa for residential surveys and valuations, all of which will ultimately be passed on to the consumer.

Effect of the Yianni Case

3.6 Following the 1981 case of Yianni -v- Edwin Evans & Sons (see para 5.18), the incidence of claims relating to residential valuations and surveys increased. This is clearly seen from the following figures obtained from RICSIS covering such claims for approximately half the surveying profession.

Residential Valuation Claims

[The figures below are based on the same client base throughout].

Year	No. of Claims	Amount Paid £
1977	30	205,029
1978	19	30,805
1979	27	171,032
1980	35	114,982
1981	185	963,896
1982	403	996,607
1983	385	1,588,201
1984	368	2,932,535
1985	293	1,369,134
1986	304	1,704,654
1987 (not closed)	305	1,240,480

The mortgage valuation figures show the impact which a single court decision can have. One

case can lead to an enormous increase in the number of claims. Given the range of judgments in the last decade or so surveyors have found themselves operating against a very fluid background. The effect of the Yianni decision on the number of notifications of a claim made to underwriters and the amounts paid out by them is clearly apparent. In 1985 the underwriters increased the uninsured excesses substantially, which had the effect of reducing the number of claims notified to underwriters, as payments were made direct to clients without informing insurers. But numbers and amounts are increasing again.

Residential Survey Claims

[The figures below are based on the same client base throughout.]

<i>Year</i>	<i>No. of Claims</i>	<i>Amount Paid £</i>
1977	242	299,616
1978	311	605,832
1979	302	855,526
1980	373	768,498
1981	394	912,609
1982	664	1,904,364
1983	597	1,934,770
1984	555	1,885,450
1985	464	1,231,609
1986	642	1,893,043
1987 (not closed)	553	1,698,601

3.7 The significance of these figures lies in the fact that although they relate to small jobs, those jobs have an immediate and direct affect on the consumer. The £12 million total estimated cost of claims per annum—the lowest estimate available, is equally significant. It is spread over a number of small claims arising from many very small jobs, mainly stemming from around two million house sales a year. Claims for other categories of surveying are not listed because, as yet, they are few and far between. However, they vary greatly in magnitude; hence it is not possible to produce a meaningful average. One well-publicised claim involving commercial property which was eventually settled out of court, is rumoured to have been settled at a figure in excess of our estimated £12m total cost of claims per annum (see above).

Extension to the ‘scope of duty’

3.8 Today the surveyor is increasingly at risk from claims by both clients and third parties in contract and in tort. Professional liability and associated PI insurance difficulties were experienced earlier this decade and still exist. The scope of a surveyor’s duty of care has gradually

been extended, not through Parliament, but by judicial decision. The legal rules of liability have become more complex, and recent case law has emphasised the inability of the surveyor to exclude liability in most cases. This increases both the insurers’ perception of risk and the insurance premiums charged. It has to be recognised that higher premiums contribute to higher costs for the public to bear.

Run-off and Knock-on

3.9 It is worth highlighting some aspects of liability which are of concern to surveyors:

- (i) Under existing law liability for negligence may continue so that retired practitioners have continuing liability which passes to their estate on death and has to be insured against through the placing of ‘run-off’ cover. This problem could be diminished for professionals if there was a better defined and shorter statutory period of time beyond which claims could not be brought;
- (ii) There is a ‘knock-on’ effect in some actions whereby a number of professionals, eg a surveyor, an engineer and an architect may all be sued by a single claimant. On the basis of joint and several liability and regardless of the proportion of damages for which the surveyor is adjudged liable, if all the other co-defendants go into liquidation or go bankrupt, he has to meet the full claim himself, through his insurance cover or his personal assets. The Study Team were unable to judge the exact size of the problem as no statistics are available, but it is of some concern to surveyors.

Reactions to Risk

3.10 As some areas of surveyors’ liabilities are emphasised and other areas emerge, it is feared that increasingly practitioners will react by ceasing to offer certain services which are regarded as too costly to provide. Alternatively they may engage in defensive practices by inserting hedging and qualifying comments in reports. Each of these reactions is already in evidence. Neither is in the public interest and a reduction in the quality and scope of services on offer merely reflects the greater exposure to negligence claims (see para 5.19).

3.11 In speaking about liability problems in a House of Lords debate on professional liability in 1987 Lord Morton of Shuna stated:

“... a very strong public interest is involved, not necessarily different from the interests of

the profession. The public interest is vital if standards...are to remain high and perhaps even be enhanced. What we, as a society, should be seeking is an even higher standard of ability, accuracy and professional integrity. It is at least doubtful whether this is best achieved by making the adviser constantly worried about the threat of litigation”.

3.12 Also the public is better advised; consequently surveyors now operate in a more litigious society. The idea of suing the professional has become popular in this country with the risk of litigation growing all the time. If a similar situation arises here as has happened in the USA where litigation is commonplace (see para 7.14), it is the public who will eventually have to bear the cost and who will suffer. The number of claims settled without payment by insurers (50 per cent) might indicate that many have no reasonable basis in fact.

3.13 The Study Team approves of and welcomes any moves which practitioners make towards quality assurance. The adoption of appropriate critical paths, programming and marshalling all the necessary ingredients for decision making, and perfecting methods by which to achieve results, all lie along the route to a reduction in claims. Part of the required practical approach is to suggest that all practitioners adopt the highest in-house standards. More important, the Government should reconsider their position towards competence standards being applied generally, including the introduction of regulations under section 22 of the Estate Agents Act 1979 (see para 8.4 (iii)).

SECTION 4

Consumer Considerations

4.1 Consumers want a quick, cheap, competent service which always provides the right answer. These aims are not always compatible. Clearly the more carefully controlled and comprehensive the service offered the more it will cost and the longer it will take to deliver. The April 1989 House of Lords decisions may make a move in this direction inevitable.

Consumer Survey

4.2 To assist the Study Team's knowledge of the public's understanding and expectations of the services on offer, a random sample of users was invited to complete a Questionnaire. A total of 942 questionnaires were sent out to individuals, companies and public sector bodies. 364 replies were received; a response of 38.6 per cent. Of those who responded, 133 (36.5 per cent) had not used any of the services listed in the questionnaire. The four main services used by those responding were: Estate Agency—170 (73.6 per cent); Property Valuation—105 (45.5 per cent); Full Structural Survey or House/Flat buyers report—94 (40.7 per cent); Mortgage Valuation—92 (39.8 per cent). (A summary of these main findings set out here is at Annexe VI.)

4.3 The number of replies received was above average for a survey of this kind and provided a representative sample of a reasonable size. Furthermore the results were consistent with our conclusions drawn from the insurance statistics we have examined. For example the incidence of claims or possible claims was typically low (see para 3.1). Only 26 (11.3 per cent) of those who had used some of the services said they were dissatisfied with the services provided. Of these, only 4 (1.7 per cent) had brought a claim within the last five years—none with legal aid. Only one of those was dissatisfied with the way the claim was handled 'because he lost'.

Typical Cases

4.4 It was clear to the Study Team that in order to explore the issues being raised we needed to acquaint ourselves with the range of negligence cases which could arise. Some examples of professional negligence cases

brought against surveyors, and demonstrating the variety of circumstances which can be involved, are as follows:

- (1) An outline planning permission obtained by a developer was allowed to lapse by his professional adviser and the local planning authority indicated that any further application for outline planning permission was likely to be refused. The professional was successfully sued in the Courts for negligence by the developer;
- (2) A proposal to reduce a rating assessment on an empty old warehouse to a nominal figure was withdrawn by a professional adviser without the authority of his client who was then presented with rate demands. The claim for damages was settled out of court;
- (3) A surveyor inspecting a house on behalf of a building society for loan purposes for roof repairs offered extra advice beyond his remit. The surveyor's advice to replace the felt with tiles was acted on by the borrower, and caused a collapse of the roof. The surveyor was held personally liable;
- (4) Managing agents failed to take action in time on a rent review because the details were omitted from their records in error;
- (5) An estate agent recommended to the prospective purchaser of a houseboat someone who called himself a surveyor but had no formal qualifications and proved to be incompetent. The boat was purchased on the 'surveyor's' advice and then found to have no more than scrap value; the purchaser sued the estate agent;
- (6) Estate Agents allowed shop premises for sale to be viewed unaccompanied, and some of the fixtures and fittings were stolen;
- (7) Contrary to the conditions of sale an auctioneer's employee permitted purchases to be removed, on receipt of a

cheque—which later turned out to have been stolen;

- (8) A Landlord wished to recover possession of his farm. He was prevented because his land agent failed to be aware of the death of the surviving joint tenant, and failed to serve notice to quit, within three months of the death, on the grandson who was running the farm and became a protected tenant.

(These examples were not obtained from the answers to our Questionnaire.)

Consumers' Association

4.5 In addition to the responses to the Clients Questionnaire we received comments from organisations and individuals [See Annexe IV] on the client/consumer aspects of the review and the public interest element, and discussed the issues raised with representatives of the Consumers' Association and the National Consumer Council. In essence the consumer case is best illustrated by the comments of the Consumers' Association. They have indicated that they are principally concerned about:

- (1) consumer difficulties experienced in pursuing claims;
- (2) consumer difficulties in obtaining expert witnesses;
- (3) the significant distinction between errors of judgement which do not give rise to compensation, and negligence which does;
- (4) uncertainty in the law so that consumers and professionals do not know where they stand;
- (5) consumer entitlement to compensation for negligence.

(The full text of the Consumers' Association's letter is at Annexe V.)

4.6 The Consumers' Association's doubts over the adequacy of remedies for negligence, prompts the question, whether all surveyors should carry PI insurance. Some estate agents are not members of professional bodies and 'surveying' is a non statutory profession. Hence, while a person cannot call him or herself a 'chartered surveyor' for example, without being a qualified member of the RICS, anyone can adopt the title of surveyor and undertake surveying activities. Unqualified people may not be members, for example, of the RICS or ISVA and thus will not be subject to professional disciplines and in particular will not be required to carry PI insurance. In the circum-

stances the Study Team considers that PI insurance cover should be a mandatory requirement for all those providing surveying services, whether formally qualified or not (see para 8.4 (v)).

National Consumer Council

4.7 We have also studied the National Consumer Council's Report 'Complaints about Negligent House Surveys/Valuations' which recommended:

- (1) that the Building Societies Ombudsman should be able to deal with complaints that prior to the grant of a mortgage the building society had been negligent in the provision of a survey or valuation;
- (2) that the Legal Aid Board should address the problems caused to consumers by the rigid application of the means test;
- (3) consumers should consider carefully whether they should obtain a survey of their own rather than relying on a building society valuation and that building societies should ensure that prospective borrowers are aware of the nature and worth of a valuation obtained by the society.

4.8 We have carefully considered the points made by the Consumers' Association and the National Consumer Council and appreciate their concern. The proposal for extending the Building Societies Ombudsman is discussed in paras 5.29 and 5.30; the allocation of legal aid is considered in paras 5.21–5.28; and the need for better consumer understanding of what mortgage valuations and surveys provide is covered in para 4.18 and 8.4(i). This last matter has also been taken up by the Consumers' Association in the 'Which?' 'Report on House Transfer' and more recently in the February 1989 'Which?' Survey 'How Surveyors Measure Up' which supports the idea of vendor surveys (see para 4.9), supports changing the rules on compensation so that the amount awarded will meet the cost of putting faults right (see para 5.11), and is concerned to retain unlimited liability for cases involving individual consumers (see para 6.20 and 7.15). Of particular importance is that it fairly, fully, and clearly spells out for its members the differences between, and the aims of, valuations and surveys; it is an excellent guide to understanding these services.

The Law Commission Papers

4.9 In addition we have studied two consultation papers, published by the Conveyancing Standing Committee of the Law Commission in November 1988, in which it was proposed that

house sellers should tell buyers what is wrong with their property. Currently vendors are not obliged to provide any information concerning the physical condition of the property for sale to prospective purchasers, who have to find out all the material facts for themselves. The Committee proposed that vendors should be under a legal duty to disclose in advance all the material facts about their property which they know or ought to know. The Standing Committee wants the whole issue of disclosure by vendors re-examined as part of the current conveyancing debate.

4.10 The abandonment of the *caveat emptor* principle was not part of the remit of the Study Team. However, we doubt whether the survey aspect is a cause of delay in house purchase. If there is a proper case for arguing that there are enforced and unwanted delays, then the Study Team considered that such delays were more likely to be caused by the inability of local authorities, and the land registration system itself, actually to carry out the work in connection with searches within an acceptable time frame.

4.11 Any move towards a greater duty to disclose or, indeed, a requirement for vendor surveys, would clearly widen the scope for actions in negligence against professionals as well as vendors, and from an unknown number of third parties on a variety of grounds. A fundamental defect of a system of vendor surveys is that it could create a serious conflict of interest for a surveyor. Moreover it is possible to conceive circumstances in which a surveyor could be sued by both a vendor and a possible or actual purchaser. It will be for others to say whether the resources exist to handle a vastly increased volume of survey work without contributing to the alleged existing delays, but in passing we have noted how few building surveys are carried out: it is estimated that approximately 5 per cent of housebuyers opt for a building ie full structural survey, about 8 per cent have housebuyers reports, and some 87 per cent opt for mortgage valuations alone.

Other Consultations

4.12 It is appropriate here to refer to the discussions held by the Study Team with practitioners in different parts of the country. To obtain a regional perspective we held meetings outside London including the North East, the South West, and the North West. Also we consulted the Building Society movement, both the BSA and individual societies.

4.13 The Study Team can record that genuine concern has been expressed about the need to safeguard the future interests of consumers specifically and the public generally. For example, auctioneers connected with fine art have made the point that British firms, unlike those in other countries, have traditionally operated as consignment auctioneers ie the auctioneer conducts business on an agency basis, selling chattels on behalf of the client. The converse—that the auctioneer buys in and then sells—is open to a conflict of interest and the possibility of detriment to the client who originally sold to the auctioneer. Similarly where the selling of financial services is linked to eg house purchase, including the valuation/survey arrangements, the client might be pressurised into buying the other products.

Cost to the Consumer

4.14 One of the Study Team's concerns was the financial effect on the consumer of surveyors' fears about negligence risks and PI insurance considerations. Ultimately it is the consumer who has to pay. At a time of intense competition between practitioners, lower costs for the public might result in the short term. But in the longer term fees will almost certainly rise. Similarly shifts in the level of PI insurance premiums will also affect the level of fees charged. Uncertainty about liability in law also adversely affects the consumer since advice given will be more restricted and qualified than hitherto. Clearly a more stable and certain climate would be in the public interest.

4.15 The professional bodies for surveyors consciously maintain and promote the standards of the profession for the public advantage. Furthermore, they are in no doubt that it is in the public interest for professional people to provide their services competently and with due skill and care, and for the victim of professional negligence to be compensated.

Quality Assurance

4.16 In looking at the standards of the profession, the Study Team has considered whether the public interest might be better served through Quality Assurance. Quality Assurance, a declaration given to inspire confidence that a particular organisation is capable of consistently satisfying need, is provided through a Quality System. This system is an organisational structure of responsibilities, activities, resources and events that together provide procedures and methods of implementation to ensure the capability of an organisation to meet quality requirements. The ground rules, including those for certification, are laid down in British

Standard BS 5750. A simple definition included in a paper published by the RICS in January 1989 is: 'Plan what you do, do what you plan; and record what you've done'.

4.17 It might be thought inappropriate, given that surveying is not an exact science, to try to apply a quality system to surveying services. As already pointed out in para 2.4, the service cannot objectively be guaranteed, but the great need is to institute risk management procedures which will mean that occasions for exercising judgement are always contained within a tight framework of ascertained fact and verified understanding. The RICS, ISVA, and other bodies can help to educate surveyors to come to terms with risk management, indeed even to embrace the full rigour of a quality assured service, but what will be achieved is an improved or guaranteed method, not a guarantee that the answer is right.

Public Understanding

4.18 Against this background it is not surprising and is generally agreed that the public is greatly confused about the nature of surveying services, especially for mortgage valuations and structural surveys. To assist surveyors in explaining to the consumer the services on offer, the RICS, for example, have prepared written terms of engagement for some activities and some individual firms have prepared descriptions of the range of facilities available, from which selections may be made. However in the face of extreme competition time does not always allow a 'know-your-customer/know-your-supplier' routine to operate smoothly. Both professionals and clients are often in too much of a hurry to give as much time and attention as they should ideally to the initial informal consideration of the task to be undertaken. Risk management procedures should address the problem, but as the 'Which?' Survey of February 1989 indicates, large sections of the public still do not understand the nature of surveying services.

Loan Certificates

4.19 One suggestion we have considered as a means of containing the liability of the professional is that instead of mortgage valuations, a certificate be sought for the amount of loan required to buy a property. The idea is superficially very attractive but on examination it proved fraught with difficulties, not least that a valuer is being asked to do something for which he is not trained and not qualified. A Certificate of Value would not solve the problem either since it is really a valuation by another name. On a more practical note, such a scheme would

only work if the certificate was interchangeable between societies which would, contrary to present practice, have to operate compatible computer records systems and standardise procedures for valuation reports. A 'floating' certificate would rapidly go out of date.

Striking a Balance

4.20 "The issue is not one of the professions' interests as against the consumers'. It is a question of establishing a fair balance" (Lord Chorley speaking in the Debate on Civil Liability and the Professions in the House of Lords on 18 March 1987). A system which is fair to all parties and provides prompt and fair compensation must be encouraged. The rights of one party should not be promoted at the expense of the rights of the other, otherwise the resultant imbalance would be of indirect but far-reaching detriment to the economic health of the community.

SECTION 5

Legal Aspects

5.1 Our terms of reference ask us to:

“Obtain information about how the law has operated in the past and how it currently operates in relation to actions in negligence against members of the profession...”

and to consider how international, particularly EC developments, have affected or may affect the above.

Current Law

5.2 The principal ways in which the law operates must be considered in relation to: contract; tort; and statutory intervention (which of course affects both contract and tort).

Contract

5.3 A professional man's liability in contract arises only as between him and the person with whom he enters into the contract. It does not, in general, extend to third parties. The liability which a professional man undertakes in contract depends on the terms of the contract. Those terms may be express or implied. If the contract is recorded in writing, proof of the express terms will not cause difficulty. If the contract is oral, proof of the terms may prove difficult, either because the parties cannot remember what the terms were, or because they disagree as to what they were. For this reason, one of the concerns which has been expressed is the frequency (or lack of it) with which instructions are confirmed in writing before they are acted upon. There are signs that, *force majeure*, matters are improving: 55 per cent of those responding to the Professionals follow-up Questionnaire said that they had changed their working methods because of PI considerations.

5.4 Often, however, the parties have not agreed terms, or have agreed terms which give only a partial picture. In this event the law will often imply terms. Where the contract is for the production of a thing (including a building) the court will usually imply a term that the thing will be reasonably fit for the purpose for which it was produced. In effect, this means that the maker of a thing is required by law to guarantee that the thing he produced will work. However,

where the contract is a contract for the provision of advice, the court will not imply a term that the advice is correct. It takes the view that many of the tasks required to be undertaken by professional men do not admit of a 'right' answer. In such cases, unless there are exceptional circumstances, the law will imply a term to the effect that the advice is given with reasonable skill and care. The common law has now been codified in this respect in the Supply of Goods and Services Act 1982¹.

5.5 One question to be answered is whether the distinction between the standard of performance required of the maker of a thing and the giver of advice is justified from the point of view of the consumer? Is it justified as a protection for the professional? In our view it probably is, because to impose on the giver of advice a requirement that his advice will be right imposes an impossible burden on the professional in most cases and adds a further dimension to the whole raft of problems. For example, if the surveyor is required to be right, he must have the opportunity to carry out the necessary investigations. But in the case of a building survey he may not be given the opportunity to investigate fully without access to the floorboards. And most vendors would not allow surveyors to lift carpets etc. In the case of a house survey where access is allowed the problems might not be so great, but in the case of a valuation there is in any event no exact answer.

5.6 Traditionally the common law has allowed parties to enter into whatever contracts they please. However, there has been a steady retreat from freedom of contract over many years, and the Court now has wide powers to intervene under the Unfair Contract Terms Act 1977. In particular section 3 prohibits the exclusion or restriction of liability for breach of contract unless the clause in question satisfies the test of reasonableness². The Act offers a number of guidelines to assist in defining what is reasonable³ but ultimately the question is one for the judge. Thus where parties enter into a contract which contains terms which seek to

exclude or limit liability for breach neither party can be sure, at the time of entry into the agreement, whether it is effectively legally binding. While we have no quarrel with the principle of protecting consumers against unfair contract terms, it would be desirable for this to be done in advance of making the contract, thereby promoting certainty.

5.7 It was once thought that a surveyor could only incur liability for professional negligence in contract and only to his client. For some time the courts have decided that a surveyor can incur liability to his client in contract and in tort and to a third party in tort usually for common law negligence. Certain aspects of negligence in tort can be highlighted.

Tort

5.8 First, liability in tort depends on *fault*, ie proof by the plaintiff that the defendant professional has fallen short of the *standard of skill and care* to be expected from the ordinary member of that profession, coupled with proof of damage caused by that fault. However, the Courts may not be the best place to determine questions of professional fault. Courts can only act on the basis of expert evidence, with the inevitable result that the 'better witness' often wins the case. We have considered the possibility of alternatives to going to court; we have also looked at the scope of the Building Societies Ombudsman (see para 5.29), and other dispute mechanisms (see para 5.32).

5.9 The kind of damage which it is necessary to prove depends in part on the nature of the claim. In most cases the damage must be damage to some pre-existing property of the plaintiff or to his person. The law takes the view that a person has the right to have his body and his property protected from the carelessness of other people; but if he is acquiring a thing (including a building) from another person, he must protect himself against defects in that thing by the terms of the contract under which he acquires it. In general, therefore, the law of tort does not provide a remedy for what is described as pure economic loss.

5.10 This is not so where what is given is advice. In such a case, the plaintiff is entitled to claim for pure economic loss. If a surveyor negligently surveys a house, with the result that the plaintiff pays too much for it, the plaintiff is entitled to recover damages equivalent to the difference between what he paid for the house and its true value at the date of purchase. Is this distinction justified? Since the purpose of the advice is normally to guard against economic

loss, we believe the distinction is justified. However, the measure of damage needs consideration.

5.11 The Consumers' Association have argued that if a negligence claim is successful, the consumer should be awarded the amount it will take to put any faults right—not just the difference between what was paid for the property and what should have been paid ie diminution of value. It is common to find that the diminution in market value is less than the cost of putting right the defect, although in some cases they may be the same. The discrepancy between the two is more likely to be found in small cases, because there is always a band of values which could be said to be the market value of a particular property. Although the award of damages based upon diminution in market value follows logically from the general principles upon which damages are awarded, we believe that, particularly in small cases, the consumer is not adequately compensated. This would require a change in the law. Any change would in our view need to eliminate, where practicable, betterment which would otherwise accrue to the consumer. However we can see merit in this approach within a given ceiling, and believe that it should be explored more fully (see para 8.6 (xii)).

5.12 Secondly, the duty imposed by law is not merely a duty of care, but also a duty of *skill*. The professional may be liable in negligence despite being extremely careful if he did not have the requisite skill to deal with the problem in hand⁴. If the professional holds himself out as an expert in a particular field, that is the standard which will be required of him⁵.

5.13 Thirdly, the duty of care imposed by the law goes further than a duty to the client; it is also to a third party. Its limits, are to a large extent dependent on the current tide of judicial opinion. It is now clear that the duty of a surveyor acting for a lender will extend to the borrower and vice versa⁶; a surveyor acting for a vendor may owe a duty to the purchaser, even subsequent purchasers, but probably not to the neighbours⁷. The same duty is owed whether the advice is given for a large fee or for nothing at all. The leading textbook on Professional Negligence concludes:

"Since the matter depends upon the particular facts and circumstances of each case it is impossible to catalogue the range of third persons to whom the surveyor may owe a duty of care⁸."

5.14 This is clearly a difficult position for the professional. However, it is likely that in the

case of the services with which this Study Team is concerned this problem is usually regarded as being of less gravity than in the case of the professional services being reviewed by the other Study Teams. The reason for this difference is that the relationship between consumer and surveyor is usually more personal, more straightforward, and direct. It has also been unclear whether the professional could exclude his duty of care to third parties by some form of notice or agreement since the decisions on two relevant cases in the Court of Appeal were divided. The House of Lords reviewed them in April 1989 but while removing one uncertainty, others have emerged (see para 5.18(e)).

5.15 Fourthly, there is the case of joint *tortfeasors* where the plaintiff's loss is caused by the negligence of more than one person, and he is entitled to sue each of them for the full amount of his loss. As between themselves, the tortfeasors are required to contribute according to the degree of responsibility for the loss, but this apportionment is of no concern to the plaintiff. In a sense therefore, each potential defendant is the guarantor of the solvency of the other potential defendants. This is widely seen as an injustice. We agree with this view; if a man is 60 per cent responsible for a loss it is inequitable that he should be exposed to liability for 100 per cent of that loss (see paras 3.9 (ii) and 9.7–9.10).

5.16 Fifthly, since the tort of negligence requires a combination of carelessness and damage, it follows that no cause of action arises until damage is caused. In the case of a negligent house survey the damage is said to occur when the house is bought, for the plaintiff has then spent his money. But in other cases there may be a considerable period between the act or omission complained of and the occurrence of the damage. Concern about the application of the law of tort to negligence is not new; in 1978, for example, the Royal Commission on Civil Liability under Lord Pearson looked at the tort system.

Case Law

5.17 In the last decade professional liability for negligence has been extended more and more by the Courts to what some would argue is an almost excessive degree. In 1972 Lord Denning stated:

“In recent years the law of negligence has been transformed out of all recognition”.

Some fifteen years later Lord Denning stated in a House of Lords' Debate:

“A reasonable, prudent man has been transformed by the law into the perfect man who never makes an error of judgement, who never looks on one side and who never forgets anything he has learnt in the past. It has come to the situation where, even if there has been an error of judgement or any little mistake or mischance, the law holds the professional man negligent.”

5.18 In 1981 the decision in *Yianni v Edwin Evans & Sons* extended the liability of a valuer acting for a client, a lender, to a third party, the mortgagor/purchaser. The court held the borrower to be entitled to rely on the valuation even though he had not seen it. Since then several other cases have extended the ground rules for suing for negligence:

- (a) in assessing damages recovered by a lender, the lender is not bound to enforce the borrower's contractual liability to repay the loan¹⁰
- (b) grants received by a plaintiff do not reduce the amount of damages recoverable for a negligent survey¹¹
- (c) a surveyor must follow the trail of suspicion even if this involves lifting carpets or moving furniture¹²
- (d) a surveyor instructed to handle a rating valuation was liable for the inability of his client to buy the freehold under the Leasehold Reform Act 1967¹³
- (e) in April 1989 the House of Lords upheld the decision in *Yianni v Edwin Evans & Sons* in their decisions on *Smith v Eric S Bush*, and on *Harris v Wyre Forest*, and also decided that a valuer preparing a mortgage valuation of an inexpensive dwelling house could not, by notice, prevent a duty of care to the borrower arising, where he knew that his valuation was likely to be relied on by the borrower. The court did not however decide whether the same principles would apply to a valuation of an expensive house or to a valuation of commercial property. For the time being, therefore, the law remains unclear in this respect⁹.

Implications of Court Decisions

5.19 As a result of these decisions thus far, claims particularly for valuation and survey work have increased dramatically, insurance premiums have increased, and professional concern, fear of liability risks and the attendant uncertainty have also increased. There is a little evidence from the Professionals Questionnaire

that the availability of services on offer is declining with some 30 per cent of respondents cutting back residential services and some 25 per cent reducing commercial services (see Annexe VII). In consequence it is feared that the consumer specifically and the public generally will suffer ultimately and be forced to bear the outcome.

5.20 The main problem for the professional is one of uncertainty. Statutory intervention has, if anything, increased the uncertainty. First there is the wide judicial discretion implicit in the Unfair Contract Terms Act 1977, coupled with the uncertain scope of its application. Secondly the amendments to the Limitation Act introduced by the Latent Damage Act 1986 potentially have extended considerably the period for which the professional is liable (and will consequently have to remain insured). But to some extent the uncertainty is a problem for the consumer too (see para 4.5).

Legal Aid

5.21 In the course of the review it was repeatedly put to us that the way in which the legal aid system is operated works unfairly against the surveyor against whom a claim for professional negligence is pursued through the courts. It is argued that the settlement of a case is discouraged by the legal aid system. Under the Act, the legal aid fund has a first charge on any property recovered or preserved in the action. That charge is always enforced. It is recognised that plaintiffs who are not legally aided, who are suing surveyors, have to take into account their own costs and, if the action fails, the cost of the defendants' solicitors, when considering whether to pursue their cases. This liability for costs also affects the judgement of plaintiffs in relation to any offer by defendants to settle out of court. But legally aided plaintiffs know that out of any damages they recover from defendants (or their insurers) they must first pay the legal aid fund; they are, therefore, only liable for their own costs and normally do not face a real risk of having to pay the defendants' surveyors' costs should their action fail. In some cases this discourages settlement.

5.22 The Study Team has noted that use of legal aid is also open to question in the case of alleged negligence by professions other than that of surveying. For example it was reported by the press last year that a study of 100 random files of medical negligence cases in the West Midlands revealed that at the end of three years 73 per cent of these legally aided actions had been withdrawn; 12 settled out of court; one

lost in court by the plaintiff; 14 were pending of which nine were likely to reach court.

5.23 It seems that where a claimant in a surveying or valuation case is known to be legally aided the inclination of the defendant is to settle quickly out of court even when the claim is thought to be worth fighting on its merits, simply because the case would be too expensive in terms of costs and time and because even if the defence was successful the costs of the defence could not be recovered from the legal aid fund unless severe financial hardship could be proved under the terms of the Legal Aid Act 1988. In such cases we believe that the operation of the legal aid system goes too far in protecting the interests of the legally aided litigant and the public purse and is unfair to the non-legally aided defendant.

5.24 We have tried to obtain hard evidence to support or refute these views, but this has not been easy. We consulted the Lord Chancellor's Department who advised us that of the total net expenditure on civil legal aid in 1987/88 of £117.1 million, a net sum of £44 million was spent on non-matrimonial civil legal aid. It is not possible to identify how much of the latter goes into fighting negligence cases against surveyors.

5.25 It seems from the figures provided by the Lord Chancellor's Department, that of all the cases coming before the Court of Appeal, Civil Division in 1987, there were 31 cases involving 'building disputes' (professional negligence by architects, structural engineers and other professional builders) and 'other professional negligence' (all professional negligence other than that included under 'building disputes'). While these are very broad brush categories it is interesting to note that in 1985 there were only 10 such cases, representing 1.2 per cent of the total cases as against 3.4 per cent in 1987. This is an upward trend in line with all our other findings. However, the number of these cases which involve legally aided plaintiffs is not known.

5.26 We have heard from the insurance industry that time and again the fact that a claimant is legally aided means that the building societies with in-house valuers, or individual surveyors, will settle out of court regardless of the validity of a case. As a result premiums are increased and the costs in turn are ultimately passed to consumers through increased fees.

5.27 Finally, and again this is anecdotal, it is suggested that because of the way the legal aid

system operates, particularly on the question of costs, the advice given to many legally aided clients by their solicitors is to take their claim all the way through the courts. We believe this to be the case although we are aware, as the Lord Chancellor's Department have pointed out, that the system is designed to prevent the expenditure of taxpayers' money in cases where it would not be justified and to protect unassisted litigants from having to defend unreasonable cases. It has also been pointed out that the legal aid arrangements do recognise that opponents of legally aided parties should be protected as far as possible both from unjustified suits and from legal aid being used to threaten those who must fund their own cases.

5.28 We consider, however, that the legal aid system is unduly favourable to a legally aided plaintiff. A successful non-legally aided defendant should be entitled to recover his costs against the legal aid fund—as a matter of course, in the same way as he would be entitled to recover his costs against a non-legally aided plaintiff. We recognise that this will require an increase in public funds allocated to civil legal aid. However the net sum spent on non-matrimonial legal aid is currently only £44m across the whole range of civil cases and we do not think that an increase in public funds allocated to legal aid is too great a price to pay to remedy a widely perceived injustice and one which tends to increase the price of services to the consumer (see para 4.14).

Ombudsman

5.29 It has been strongly recommended to the Study Team by the National Consumer Council and the Consumers' Association, that the Building Societies Ombudsman's powers should be extended to enable negligence claims to be handled. On the face of it the proposal has much to recommend it involving as it does an independent body which would remove the consumer's fear of going to court; it is also claimed that wider references to the Ombudsman would save time and money, and avoid the need for expert witnesses. However, in practice, it would not obviate the need for an exhaustive review of the issues involved and this would imply the need for expert witnesses. Alternatively the Ombudsman would need his own team of experts to cover the whole country so as to be able to assess each claim individually but this would present a major resourcing problem.

5.30 Maladministration raises very different questions from those arising on negligence compensation and damages. In the latter case

either a physical examination of the property is involved or a rigorous examination of expert witnesses. Consequently the savings in costs and time would not be as great as has been suggested. More seriously, in evidence it was proposed by the consumer bodies that the Ombudsman would not be an absolute alternative to the Courts and that proceedings in front of the Ombudsman would not preclude subsequent proceedings in court. The Study Team felt that such an arrangement would prejudice the court hearing. However we have looked at this option again in our recommendations for further action (see para 8.5 (viii)).

Model Clause 'Certification'

5.31 Another possibility we have considered which might assist in ameliorating the problems of negligence claims across the whole range of surveying services concerns the use of recognised standard exclusion or limitation of liability clauses in a contract. A scheme might be devised whereby a statutory body like the Office of Fair Trading approves standard clauses submitted by professional organisations for use by their members and others, and certifies that it is a reasonable clause for incorporation into a contract between a professional and a consumer. The effect of approval would be to remove the Court's powers to invalidate the terms of the contract after the event. It would require amendment of the Unfair Contract Terms Act 1977 so that the operation of the Act would not then apply to a contract made on those terms. Both parties to the contract would know that if they contract upon OFT—approved terms, they are bound by the contract, and there is no possibility of the Court striking down an exemption clause. This proposal would promote certainty and enable insurers more accurately to gauge the risks which they underwrite.

Other Dispute Mechanism—The RICS Arbitration Scheme

5.32 The Chartered Surveyors Arbitration Scheme was introduced in June 1988 to provide an informal and inexpensive means of settling simple disputes between chartered surveyors and their clients. Under the Scheme an independent arbitrator is appointed to settle eligible disputes, each party paying a £57.50p registration fee. Parties agreeing to use the scheme are both bound by the result and further action on the same matter in court is thereafter precluded, but a surveyor is not obliged to agree to use the scheme.

5.33 This scheme sets no financial ceiling on the size of the case which can be handled, and

helps reduce the costs of settlement at an early stage. To ensure that it would be seen to be independent, the RICS asked the Chartered Institute of Arbitrators to administer the scheme; nevertheless it is clear that the consumer doubts its independence. Moreover the scheme does not cover disputes between building society valuers and surveyors and their clients. Despite these drawbacks we believe that the scheme has potential for a wider application, particularly in handling non-lender disputes.

Note:

References in the Text of Section 5—are to be found in Annexe VIII.

SECTION 6

Insurance Aspects

6.1 A number of professional bodies require compulsory PI insurance.

6.2 Under the RICS rules of membership, since 1 January 1986 all Chartered Surveyors in private practice, on their own account or as partners, or as directors of a company, who are members of the RICS are required to carry professional indemnity insurance against claims for breach of professional duty. Their insurance cover may be obtained wherever members choose, but it must be 'no less comprehensive' than the cover provided by the policy issued by RICS Insurance Services Limited. Members must carry as a minimum indemnity insurance up to £100,000 if the gross fee income does not exceed that amount or £250,000 if it does.

6.3 The conditions imposed by the ISVA on its members are virtually identical and expressly require insurance cover to be held for negligence and breach of professional duty, breach of contract, breach of warranty of authority, conversion and also against dishonesty by any past, present or future partner, director or employee of the member (and therefore, cover is similar in scope to that provided by RICSIS). The minimum amount of insurance specified is £100,000 for sole principals and £250,000 for other firms wherein at least one of the partners or directors is a Corporate member of ISVA. The ISVA's scheme, mandatory since 1 October 1982, is run by Valuers Auctioneers and Estate Agents Group Insurance Services Limited (VAEGIS).

6.4 RICS Insurance Services Limited, Valuers Auctioneers and Estate Agents Group Insurance Services Limited, the Dominion Insurance Company and Sun Alliance Insurance, all arrange policies which comply with RICS/ISVA rules, but members are free to insure in any UK approved office.

The Professional Indemnity Market over the last Decade

6.5 We have looked at the trends in the availability and cost of professional indemnity (PI) insurance over the last decade; this has been particularly apposite because over several

decades now the insurance market has shown itself to be cyclical, with difficulties being experienced every ten years or so. The period under review has been one of significance for the market particularly in terms of the economic and social climate and the extension of professional negligence in tort through case law decisions. The cyclical nature of insurance operations is also changing because new technology has created circumstances in which the cycles become shorter.

6.6 By the early eighties the high level of premiums for PI insurance, as against the level of claims, was attracting a large number of insurers into the market. The established sources of PI insurance were substantially undercut and premiums were forced down to an artificially low level because of the market's over-capacity. For several years the market experienced fierce competition and excessive premium cutting. High interest rates continued to attract insurers into the PI market until decided case law extended the vulnerability of professional firms to claims in negligence. At the same time, inflation was increasing and in many cases the insurers' reserves proved to be inadequate to meet the damages awarded by the courts.

6.7 The rise in claims was linked to the court decision in the case of *Yianni v Edwin Evans & Sons* (see para 5.18). Once the case was reported the number of notifications of claims, and successful claims greatly increased.

6.8 Against this background, settlements and claims' handling costs, rapidly and substantially exceeded premiums. Many of the newer underwriters made a hurried departure from the scene. The withdrawal of these underwriters and of almost all reinsurance companies (20 reinsurance companies had withdrawn from the PI insurance business by mid-1985) led to an immense loss of capacity in the market and a sharp and rapid rise in premiums.

Present Position

6.9 There is at present again a considerable choice of insurers capable of providing cover of

the quality required by the RICS Regulations up to a level of at least £50 million for *each and every claim*. In addition a further £50 million is available from the insurance market, but mainly on an aggregate limit basis (as opposed to an 'each and every claim' basis).

6.10 Generally surveyors are not experiencing difficulties today in obtaining high quality cover up to £50 million for a premium which may be thought to be a not unreasonable percentage of gross fee income. For all levels of cover increased premiums (of up to almost 400 per cent in some cases) were reported in 1984/85, but since then premiums have become more stable and in some cases have started to fall. Nevertheless further major increases are forecast over the next few years.

6.11 In addition, in the last few years the uninsured excesses have risen steeply and it was suggested to the Study Team that in this way the cost of claims, especially for valuations/survey work, has been shifted by the insurers onto the surveying profession. In fact it is recognised that despite PI insurance policy requirements many claims are settled within the uninsured excess without notifying the insurers. We understand that what is notified to the insurers is only the tip of the iceberg. Advice from the insurance industry is that the total cost to the surveying profession runs into many millions of pounds in addition to the premium. Most of these hidden costs will ultimately be passed on to the consumer (see para 4.14).

6.12 The Study Team's attention was also drawn to the fact that when the house market was very active in the summer of 1988, tremendous pressure was exerted by mortgage lenders on surveyors to provide valuations and surveys as rapidly as possible. The normal turn round periods were squeezed considerably. It was stated in evidence to us on several occasions that under the tremendous strain of these demands mistakes were made which would ultimately result in a crop of claims for negligence (see para 6.18).

Future Position

6.13 On the surface the PI insurance market for surveyors is more settled now and the market is softer. Court decisions on further professional negligence cases since *Yianni* have increased the liability risk and the probability of consumer litigation, and the climate has encouraged surveyors to tighten up their procedures.

6.14 The signs are, however, that a recurrence of earlier problems which in turn could lead to

difficulties for the consumer, is likely to emerge in the early 1990s. If this happens the situation could be much worse than in the '80s in view of the declining numbers coming into the surveying profession, increased premiums, and marginally fewer surveying services on offer. With fewer people qualified to offer surveying services the pressures will be greater as demand increases.

6.15 Most categories of surveyor believe that a rise in the number of complaints has been detected—although this view cannot be supported with hard facts. Nevertheless the Team have noted a thread running through the comments. Increased vulnerability is being experienced among the small practitioners, particularly if they are sole principals. This is evident, for example, among rural surveyors, who are particularly concerned about the volume of new legislation which can extend the potential for negligence, and who see an increase in the number of claims with agricultural and rural communities growing more claims-conscious.

6.16 In relation to fine arts auctioneering, concern was specifically expressed over the small auctioneer. Value judgements are the rule rather than the exception (only certain genuine silver items can provide a definitive identification through hall-marking) and the President of the Society of Fine Art Auctioneers has reported a rapid growth in inquiries leading to claims. Vendor claims are increasing, as are claims related to buying blind. Many small auction houses are forming limited liability companies with the precise objective of avoiding the personal liability risk.

6.17 In addition changes in the nature of the bodies themselves offering surveying services eg the flotation of firms on the Stock Exchange, the growth in multi-disciplinary partnerships etc have led to further complications. Many small firms have been taken over by bigger bodies and this has affected the nature of the services offered to the public. At the same time the greater availability of finance coupled with other factors has rapidly increased the number of consumers seeking surveying services for the first time.

6.18 Against this background, interest rates are creeping upwards. Inflation rates are rising. And the April 1989 House of Lords decisions referred to elsewhere (see in particular para 5.18(e)) will no doubt bring forth more claims in the near future. The pressures will become greater as demand increases, the number of

qualified surveyors contracts, some services are no longer available, and fees and premiums rise.

Mandatory PI Insurance

6.19 Against the factors outlined above we have considered whether introducing a statutory requirement for professionals to carry PI insurance would be beneficial, as suggested by the International Bar Association (see Annexe IX). As part of a package approach to adjust the balance between professional and consumer, which the Study Team feel is appropriate, mandatory PI insurance has much to offer—not least that it ensures greater safeguards for the consumer, puts all professionals in a particular market eg surveyors, on an equal footing, and leads to better standards since, for example, insurers increasingly require those insured to operate risk management procedures. It also provides a more equitable basis when joint and several liability occurs. This approach would need to be applied more widely than to surveyors alone, and is justified given the recent decision that contractors cannot avoid sharing in the liability for a surveyor's negligence (*Anthony Witt v Roger Macmillan Construction Co Ltd*: The Times Law Report 16 February 1989).

Capping ie Limiting Liability

6.20 Against this background we have carefully studied the arguments in favour of limiting liability for damages for negligence by statute. Legislation could limit the number of professional claims which could proceed, but it would lead to an inequitable approach and there might be problems of definition, particularly in applying capping to a group of practitioners uncontrolled by statute. In practical terms a straightforward capping by means of a financial ceiling could still lead to hardship in some cases.

Strict Liability ie 'No Fault' Liability Insurance

6.21 The consequences of a scheme of this sort have been studied in view of the frequent references by the media to strict liability ie 'no fault' insurance. In fact 'no fault' insurance schemes for medical services already operate in Sweden and New Zealand and seem to work, and schemes have been noted for products *per se*, but as far as we are aware they have not been applied to activities such as surveying. We take the view that problems would arise if applied to surveying services. 'No fault' insurance schemes could probably be made available to surveyors if the demand is there, but premiums would be much higher than for ordinary PI insurance and doubtless this would be reflected in the fees charged for surveying

services. Ultimately the consumer and the public generally would have to bear the burden of extra costs particularly if the 'no fault' scheme is Government-backed financially (see para 4.14).

International Aspects

7.1 Under the Terms of Reference of the Study, we are required to consider international developments with particular reference to the European Community and the extent to which they have affected, or may affect: the nature of professional services offered to the public, public expectations and understanding, and the professionals' duties and liabilities; the availability and cost of professional indemnity insurance; and the operation of the law.

7.2 The international dimension of professional liability is relevant to the work of the surveyors we are reviewing for several reasons. Many UK surveyors already operate abroad either as part of an overseas office with a home base, or on individual assignments. In both cases PI cover may be required or at least is preferred where it is available. Knowledge of how professional indemnity liabilities affect their counterparts in other countries helps the professional operating abroad to gauge his own liability. Moreover insurance companies already operate internationally. In fact surveyors are having to become more international in line with property activities eg more joint ventures between UK and overseas firms are taking place, and cooperation between foreign companies is increasing as cross-shareholdings grow.

The European Community

7.3 We have looked at the question of surveyors operating within the European Community. In particular we looked at the EC Directive on a General System for the Recognition of Professional Qualifications¹ which was adopted by the Council of Ministers on 21 December 1988 and comes into force on 4 January 1991. Thus the Directive will enable non-UK EC nationals who possess the appropriate educational qualifications and training of the scope and duration required, to join UK professional bodies such as the RICS. They will then be treated by the RICS in exactly the same way as UK nationals in terms of professional

¹ Full title: EC Directive on 'A General System for the Recognition of Higher-Education Diplomas Awarded on Completion of Professional Education and Training of at Least Three Years' Duration'.

liability and in respect of the protection of the consumer's interest, and be subject to all the membership requirements of that UK body.

7.4 It does not appear that the Directive widens the scope of liability implications in the UK; thus a non-UK EC national will be liable here in the same way as his or her UK counterparts. The sole aim of the Directive is to speed up freedom of establishment for professions in the EC and to make it easier for qualified professionals within the Community to practise their profession in other Member States.

7.5 The situation following implementation of the Directive is not likely to change radically in the foreseeable future. For example, it is customary for building societies to use valuers with local knowledge of an area of the country; this requirement will still need to be met. A non-UK EC national operating here as a surveyor will, under the directive, have to have the appropriate qualifications, and equally will be subject to the law, as are UK surveyors now.

7.6 Of course, a professional operating in an unfamiliar market place may be more vulnerable to claims in certain circumstances. Equally the consumer may be more vulnerable. There is also the question of how legitimate claims against these professionals will be met, and whether they will have to be covered by insurance to safeguard the client's interests. The RICS in admitting a non-UK EC national to its membership, for example, will require it to meet the RICS compulsory PI requirements. But not all practitioners are subject to these requirements. Mandatory PI insurance would get over this problem, and in consumer protection terms would be of considerable value when anyone from abroad operates here.

7.7 The Study Team has also considered whether 1992 and the advent of the Single European Market would have liability implications. 1992 *per se* will not affect the situation. But in terms of future European policy and law in a single market it was suggested to the Study

Team that there could be spin-offs which will affect surveyors operating in the UK, and elsewhere in the EC. For example, rural surveyors who are largely UK based will need to inform themselves carefully of future EC thinking to ensure that their liability risks are minimised (see para 6.15). By way of illustration, a milk quota attached to land could be very important in valuation terms but surveyors could not assume that the quota would run beyond 1992 and their advice to a client would have to reflect this.

7.8 It was also drawn to the Study Team's attention that a research project for the Internal Market and Industrial Affairs EC Directorate is currently looking at liability, guarantees and insurance in the European construction industry. The research programme which refers to consideration of unified liability at Community level, is at an early stage. We understand, however, that the project sees itself as providing a solid basis for considering the requirements and possibilities for harmonisation of the framework in this area. If the EC were to move in this direction and look more widely at liability issues, we believe that our package of proposals, especially for compulsory PI insurance and statutory standards of competence (see para 8.4) would be very relevant.

International Survey

7.9 A wide ranging survey of insurers conversant with professional liability and professional indemnity insurance practice in eight countries (France, Portugal, Germany, Australia, New Zealand, Denmark, Sweden and the USA) was carried out for the professional liability review by Peter Madge of Willis Wrightson, for which we are most appreciative.

7.10 The most significant finding of the survey is that the liability imposed on professionals in the UK may be said to be more severe than that imposed elsewhere. Each individual aspect of liability eg unlimited liability or joint and several liability, is not necessarily the strictest, but together their combined effect is the most rigorous.

7.11 It is clear that practice varies widely across the world; in addition major changes are currently taking place, not always in the same direction. Thus in some countries professional liability is being made more onerous, eg in Canada, but elsewhere it is being relaxed, eg in the Netherlands.

7.12 Apart from France and Germany which legally define liability the other countries sur-

veyed do not generally fetter contractual terms. In federal countries the law varies from one state to another. Tort liability is frequently defined in statute in most of the countries surveyed. The criterion for liability is 'duty of care' in all except France which operates a statutory requirement of strict liability for damage affecting the 'solidity' of a building. Denmark specifically requires that the performance is that expected of a skilful as well as a careful practitioner.

7.13 Liability is capped by agreement in Germany, and is limited to fees in the Netherlands subject to lower and upper limits of roughly £43,000 and £430,000 respectively. Almost everywhere clients insist on proof of adequate Professional Indemnity insurance. All but Portugal and France have policies written on a claims made basis and the latter seems likely to follow this practice.

7.14 The survey reveals little evidence of professionals refusing to undertake assignments because of the professional liability risk except those involving the disposal of hazardous waste and asbestos abatement in the USA. It also appears from the survey that consumer concerns are largely being met. Overall it seems that the availability of insurance poses few problems even in countries where there is a high level of claims consciousness. Small countries and countries with a small exposure to claims have a limited market with a relatively low capacity. Elsewhere a more rigorous supply ensures the availability of insurance, and, more and more, professionals try to limit liability by negotiation with clients. Of all the countries looked at, it is the USA which seems to present an early warning of what might happen here in the future in terms of professional services on offer (or, more significantly, withdrawn), negligence claims brought by consumers, and the way in which contingency fees operate, etc (see para 7.16).

International Bar Association

7.15 The International Bar Association (IBA) has submitted to the Study Team its report on 'Professional Indemnity Insurance: Proposals for Legislation' (see Annex IX) which, in our view, sets out succinctly and usefully the situation today in several countries. It looks at what is happening in the United States of America, the Netherlands, and the United Kingdom in the context of a number of professions and then looks at the way ahead. A package approach is proposed involving compulsory PI insurance, and damages limited by legislation. An important qualification is made by the Association in

proposing legislation to limit professional indemnity claims: by law compulsory PI insurance would be provided 'up to a figure which would be sufficient to ensure that the man in the street recovers damages in full'. In addition the Association propose that the legislation could apply to non-professionals as well eg the contractor as well as the surveyor. We agree with the IBA view that although the problems for other surveyors and the consumer are of real concern because of the costs, the uncertainty of the law etc, they are not of the same magnitude yet as in the USA.

Contingency Fees

7.16 Concern was expressed by the Society of Fine Art Auctioneers that a shift is becoming evident in the UK, as auctioneers who formerly acted on a consignment basis move to a buyer basis. Many sale room practitioners doubt whether this is in the public interest, particularly if it were to be accompanied at some stage by the introduction of solicitors' contingency fees¹ on the lines of the system in the USA. The Study Team, which is aware of the Government's recent proposals on contingency fees, considers that if solicitors operated on a contingency fee basis, this would further encourage liability claims—regardless of whether negligence has arisen, and exacerbate PI insurance difficulties likely to arise in the future.

¹ A contingency fee arrangement is one whereby a professional person agrees that he will accept his client's case on the basis that he will be remunerated according to the outcome of the case.

SECTION 8

The Implications for the Future, Possible Next Steps for Further Consideration of the Subject, and the Study Team's Conclusions and Recommendations

8.1 The Study Team has been asked to suggest possible next steps for future consideration of the subject in the light of our considerations of all the evidence, including that put to us by various interested parties.

8.2 We believe there are a number of important changes which should be considered further from the viewpoints of both the professional and the client ie the individual consumer, and in the public interest. A number of measures have been suggested to us, some more draconian than others. Not all of these suggestions would require legislation, many simply require a change of attitude and the will to improve matters voluntarily.

8.3 Our objective has been to recommend changes only where they are viable, more equitable than the present arrangements, and would secure worthwhile improvements for the future. All the changes recommended are capable of standing on their own; however, these recommendations flow one from another, and complement each other. They are based on our findings, including the responses to our Questionnaires from professionals and consumers throughout the United Kingdom. Our recommendations generally reflect the situation across the board and are not solely tailored to dealing with PI matters in England and Wales, although we recognise that some legislation referred to below does not apply to the whole of the United Kingdom.

The Recommendations

Professional Standards and Public Understanding

8.4 *Firstly*, we looked at: the public's perception and understanding of the services available, communications between professionals and their clients and the adequacy of professionals' advice and guidance to their clients; the general standards under which the professionals and all suppliers of associated services operate; and the current requirements for PI insurance and whether they might be extended.

(i) Public Understanding of the Services Provided

It is important that the client is aware of the choice of services available when specifying the

service required, readily understands the differences in what he or she is offered, and realises the implications of following a certain course of action eg the more comprehensive the service provided, the greater the cost. Recently the Consumers' Association again advised its members to consider the implications carefully before eg opting for a valuation or a residential survey. Unfortunately clients are not always well briefed by the professionals or by the 'middle man', and therefore do not recognise the possible pitfalls (see para 4.18).

We recommend that all those concerned with offering surveying and associated services to the public should actively consider how best to improve staff training and ensure better communication with and guidance for the public. In particular all prospective housebuyers should be advised specifically on the options available to them in regard to pre-purchase valuations and surveys. The importance of the need for further action overall on this front by both professional bodies and individuals cannot be over-emphasised. It is in the interests of both the professional and the consumer.

(ii) Professional Standards

One of the duties of the professional bodies is to encourage their members to attain high standards (see paras 2.4–2.8) and keep abreast of current developments to enable them to give a better service (see para 4.15). While improvements are being made all the time, there is room for more. There is a continuing need for *all* professionals to follow the example of eg engineers, accountants and solicitors, and operate schemes aimed at educating members and keeping them up-to-date. We note with approval that by 1991 the RICS proposes to extend its compulsory continuing structured learning scheme from those just qualifying, to all its members throughout their careers; and ISVA are introducing a mandatory scheme from October 1989. Career-long continuing education will help to maintain standards and reduce claims.

We recommend that all professional bodies covered by the terms of our remit should adopt

relevant schemes for career-long continuing education for all their members.

(iii) *General Standards of Competence*

We have also considered the varying standards of services offered directly to the public when buying and selling residential property. The quality of published guidance provided, the time spent assisting clients, and the competence of the staff involved, range from the excellent to the inadequate. Some building societies, for example, have produced helpful explanatory leaflets which clearly set out the differences between a valuation, a housebuyers survey, and a full structural survey. Also their staff are specially trained to assist public understanding. Not all practitioners considered in this report operate such commendable standards (see para 4.18), but if they were obliged by law to adopt equally high standards, including the requirement to explain the purpose etc of valuations and surveys, the public would benefit and the number of claims might be reduced.

We recommend that competence standards should be introduced, including regulations under section 22 of the Estate Agents Act 1979. This would require legislation.

(iv) *Other Suppliers of Services eg Contractors*

In the context of this review we have noted the extension of liability for negligence to suppliers of associated services other than the professionals. It reinforces our view that it is vital that recognised standards should be in operation for all providers of services (see para 6.19).

We recommend that statutory standards of competence should apply to all suppliers of services linked to surveying services. This would require legislation.

(v) *Compulsory PI Insurance*

We have studied the implications of a statutory requirement for surveyors and other providers of services (see (iv) above) to carry PI insurance cover (see paras 4.6 and 6.19). We believe that mandatory cover would be in the public interest since it would encourage standards to rise, promote risk management procedures, give added protection to the consumer, and put all practitioners including non-UK EC nationals in the same market place on an equal footing. No doubt the resources of the insurance market could be expanded to provide a suitable range of policies.

We recommend that compulsory PI insurance be made a statutory obligation for surveyors and for the providers of all other services connected

with surveying (see (iv) above). This would require legislation.

(vi) *Strict Liability ie 'No fault' liability insurance*

We have considered the pros and cons of adopting this approach (see para 6.21) but it would not be appropriate for surveying services which often involve a matter of judgement incapable of empirical verification, and we reject the idea.

We recommend that this course of action, which would require a Government-financed scheme, should not be pursued.

(vii) *'Capping' ie limiting liability*

We have looked at the possibility of capping as in parts of the USA, and at the possibility of capping schemes from which parties can contract out (see para 6.20 and 7.15). The variety of circumstances which a limited liability scheme would need to encompass would be very great. At the same time the cap would need to be set at a relatively generous limit to cover most ordinary cases, and must provide freedom to contract out for higher sums. In the end the question is one of allocation of insurance risks, and in the case of large projects we believe it is probably easier for the professionals to insure than for the consumer. It would be difficult to construct a fair and practicable scheme for limiting liability; we reject the idea.

We recommend that this course of action should not be pursued.

The Purchase of Residential Property

8.5 *Secondly*, we devoted considerable time to liability and indemnity issues arising for surveyors and valuers and the public involved in buying and selling residential properties. That is the single category in which the most negligence claims arise (see para 3.2), the one area most familiar to everyone and yet the one most frequently misunderstood. We have, therefore, considered whether dispute mechanisms concerning the buying and selling of residential property might be improved.

(viii) *Lending Bodies Ombudsman*

We considered a suggested extension to the Building Societies Ombudsman Scheme so that negligence claims may be heard and costs awarded by the Ombudsman in mortgage valuation and survey cases, as an *alternative* to the court (see para 5.29 and 5.30). This would provide an informal small claims procedure and the Ombudsman's decision would be binding on all parties. It would not avoid the costs, the

time, and the difficulties involved in obtaining expert witnesses since these would still be needed in order for the Ombudsman to carry out an exhaustive review of the issues. Recourse to an Ombudsman should also preclude subsequent proceedings in court on matters of fact although an appeal on a point of law would be allowed. It would make sense from a consumer point of view to explore this option further, particularly if the Ombudsman dealt with mortgage valuation and survey cases involving all lending bodies.

We recommend that this proposal be investigated further.

(ix) *Statutory Arbitration Scheme*

The arbitration scheme of the RICS, which functions as an expert panel, should be given statutory backing; some cases naturally lend themselves to arbitration. This would remove the two criticisms—that it lacks statutory teeth to require chartered surveyors to agree to their case going to arbitration, and that it lacks independence (see paras 5.32 and 5.33). The relationship between an extended Building Society Ombudsman and a statutory surveyors arbitration scheme would need to be defined, but the two mechanisms are seen as mutually exclusive—the Ombudsman dealing with lending cases, and the Arbitration scheme dealing with non-lender disputes.

We recommend that this proposal be investigated further.

(x) *Model Clause 'Certification'*

Standard exclusion or limitation of liability clauses submitted by professional bodies and approved by a statutory body (see para 5.31) would bring commendable certainty to certain contracts for services and would assist in qualifying PI risks.

We recommend that this proposal be investigated further.

(xi) *Loan Certificates*

We have considered the suggestion that instead of mortgage valuations, a certificate be sought for the amount of loan required to buy a property (see para 4.19) but we reject the idea as impracticable.

We recommend that this course of action should not be pursued.

The Professional/Consumer Balance

8.6 *Thirdly*, we have looked at the balance between consumer and professional interests

and considered whether certain factors might be regarded as inequitable by either party, and thereby affect the availability, quality and cost of the services on offer. Our objective has been to identify possible improvements in the law which would ensure that a fair balance between consumer and professional is achieved, particularly at the most vulnerable end of the consumer market.

(xii) *Entitlements to Compensation*

For cases up to a ceiling of say £10,000 index-linked in line with inflation, the costs of rectifying negligence should be awarded on the basis of making good the damage and providing recompense for eg distress, moving costs etc. There should be some mechanism devised to ensure that figures could be adjusted to make some allowance for betterment. Above the £10,000 ceiling the rule of diminution of value at the time of purchase would still apply. This approach would be in the interest of the consumer (see para 5.11), but it would require further study before the law could be amended.

We recommend this course of action. This proposal would require legislation.

Matters for Wider Consideration

9.1 In some of our recommendations we have felt able to suggest new approaches which had special relevance to surveying activities but which could also be applied much more widely to the great benefit of all concerned. However, two matters were identified in the course of the Study which had a major impact on surveyors, but which could only be considered in a much wider context. We refer to the legal aid system, and joint and several liability; both cause concern and, it was argued, were important candidates for further study.

The Legal Aid System (see paras 5.21–5.28)

9.2 Time after time it emerged in discussions with surveyors and mortgage lenders that where a claim in negligence is brought by a plaintiff, supported by legal aid, the tendency is to settle the claim irrespective of its merits. We are not convinced that the operation of the statutory charge provides a financial incentive for an assisted person not to conduct litigation in an unnecessarily costly way. We understand from the Lord Chancellor's Department, however, that it is the Government's intention to extend the defendant's right to make representations against the grant of legal aid *before* a legal aid certificate has been granted, as well as after a certificate has been issued. This may be of assistance in some cases, but generally the challenge itself will consume resources and therefore, in order to cut losses and retain 'customer loyalty' early settlement of some cases is likely to continue.

9.3 The spur to settlement is the fact that the plaintiff can pursue his case as far as the courts will allow, although he normally has a certain protection against incurring liability for the defendants' costs if the plaintiff finally loses his case. The defendant, on the other hand, will have to meet his own costs, even to prove he is not liable for a claim in negligence.

9.4 We checked the position with insurance brokers, in order to eliminate any special professional pleading, but the result was merely to confirm that what we had been told was true. Settlements did take place in order to avoid the

costs of expensive defence which would fall either to be borne by the underwriters, or directly by the negligent surveyor through his excess.

9.5 The Lord Chancellor's Department representatives were not able to identify how many claims are pursued against surveyors with the benefit of legal aid given to the plaintiff. It is probably a relatively small number, but there are many more where the grant of the certificate is enough to alter the balance between the professional and the plaintiff client.

9.6 We felt we had reached the limit of our Terms of Reference and so did not frame a specific recommendation on this matter. It is clear to us, however, that there is a considerable fault in the system and the least action which is necessary is that a successful defendant should be able to recover his costs.

Joint and Several Liability (see paras 3.9(ii) and 5.15)

9.7 Potentially recasting the liability of joint tortfeasors would have many ramifications. What was put to us was that it was unfair for any professional person found say only 20 per cent liable for damages in negligence, to have to bear 100 per cent of the damages because of the default or bankruptcy of others also partially liable.

9.8 We recognise that cutting down the liability to only that portion for which the courts determined a single party to be liable, could clearly leave a client exposed to loss and would involve changing the law. Experience in the USA shows that State legislatures have been joined in actions, however, merely because their notional resources are virtually unlimited. Thus, if a state legislature can be held liable for even a fraction of loss, the successful plaintiff will be guaranteed the whole of their damages, because if all the other tortfeasors default, in the end the state will pay. But many states in the USA have now legislated to limit their involvement.

9.9 Some surveyors believe that the principle of joining large practices into some small part of a complex service brief, is designed to secure a 'long pocket', analogous to a state legislature, and so provide an insurance in case the work undertaken proves to be at fault.

9.10 Any change in the Civil Liability (Contribution) Act 1978 would involve all the professions and may well extend far beyond to areas of general commercial activity. Again we felt that this took us outside our Terms of Reference, although we acknowledged it to be a matter of deep concern to many surveyors. The Study Team would however, support any move to limit liability to that portion of damages for which a negligent professional was found liable. Nor would we see this as inequitable if our recommendations in section 8 were adopted, in particular, a statutory requirement for the performers of all services to take out professional indemnity insurance. In this way clients' interests would be safeguarded and clients would receive what is due to them.

SECTION 10

Conclusions

10.1 In our view the balance which would be achieved by adopting our proposed changes, including, if possible, the wider proposals to which we refer in Section 9 of this Report, should go a considerable way towards meeting the general consumer concerns put to the Team, while at the same time addressing the concerns voiced by the profession. We also attach importance to the idea that, where appropriate, our recommendations should apply to all providers of services associated with the surveying profession, and not just to formally qualified professional men and women themselves. In addition, as we state at the beginning of our Study (see para 1.4) we consider it desirable that all the professional liability issues facing surveyors and other professionals in *the public sector* should be the subject of a special study.

10.2 In conclusion the Study Team considers that before being faced with the difficulties which are likely to recur in the early nineties, these recommendations should be pursued by the Government with some urgency.

Terms of Reference for Fact-finding Studies

“In the light of current concern about the cost and availability of professional indemnity insurance and the extent of professional civil liability for negligence, to establish the facts about the effect on the following professions of the way the law operates in providing remedies to those who suffer loss as a result of the way in which a professional person performs his duties:

- (a) auditors (and other accountants in independent public accounting practice who carry out reporting functions arising out of statutory requirements)
- (b) architects/consulting engineers/construction surveyors
- (c) other surveyors (such as land surveyors and mining surveyors)

The studies should in particular:

- (i) Examine the nature of the service provided by the professions listed above, the professional duties and liabilities arising from that service, including the extent to which there are requirements to conform to professional standards and guidelines; the way in which the service is held out to the public; and public expectations and understanding of the service provided;
- (ii) Obtain detailed information about recent trends in the availability and cost of professional indemnity insurance for the professions listed above, and the reasons for these;
- (iii) Obtain information about how the law has operated in the past and how it currently operates in relation to actions in negligence against members of the professions listed above;
- (iv) Consider international developments with particular reference to the European Community and the extent to which they have affected, or may affect, (i), (ii) and (iii) above;
- (v) Assess the effects, now and in the future, of (i), (ii) and (iii) above on the availability, quality and cost of the services provided by the professions listed above, and the impact on those who rely on the service provided by members of these professions and to assess the effects of (i), (ii) and (iii) above on the effectiveness and competitiveness of these professions; and
- (vi) If appropriate, suggest possible next steps for future consideration of the subject.”

ANNEX II

Composition of the Study Team

CHAIRMAN:

Ian V Oddy FRICS, FRVA, FCI Arb

—Professional Standards Partner of St Quintin, Chartered Surveyors

MEMBERS:

John H Chapman FRICS, FRVA

—Chartered Surveyor, Former Senior Partner of Weatherall, Green & Smith, Chartered Surveyors

Brian C Grainger FRICS, FSVA

—Chartered Surveyor of Brian C Grainger

Edward T Hartill BSc, FRICS

—The City Surveyor, City of London Corporation

Kim M J Lewison MA (Cantab)

—Barrister

Ray A G Moorman

—Managing Director, Capital & Counties plc

Jeremy C Mortimer

—Managing Director, RICS Insurance Services Ltd

SECRETARY:

Lillian P H Birch

—Department of the Environment

The Study Team gratefully acknowledges the assistance of:

Christopher K. Howes, FRICS

—Director of the Land and Property Division, Department of the Environment

John C. White, ARICS

—of the Land and Property Division, Department of the Environment

DEPARTMENT OF THE

ENVIRONMENT

NEWS RELEASE

558

11 October 1988

Review of Professional Liability and Indemnity

A study team set up by the Department of the Environment and chaired by Mr Ian Oddy, Managing Partner of St Quintins (Chartered Surveyors) is investigating the professional liability and negligence issues faced by Surveyors, other than Quantity Surveyors, who are covered by the Construction Industry Review.

The study is concerned with both the professionals and consumers points of view. The Team would like to hear from members of the public and firms having used the services of a Surveyor during the past 10 years relating their experience, degree of satisfaction with services provided, and details of any disputes.

Written comments from anyone wishing to contribute to the review should be sent, by 15 November to: Miss Lillian Birch, Room C14/19A, Department of the Environment, 2 Marsham Street, London SW1P 3EB.

2 MARSHAM STREET · LONDON SW1P 3EB · TELEPHONE 01-276 3000

ANNEX IV

The Following Responded to the Request for Views from the Study Team:

Abbey National Building Society	Inland Revenue
Richard Adams FRICS	Institution of Professional Civil Servants
ADAS	International Bar Association
Alliance & Leicester Building Society	P J Large FNAEA
Christopher E Amies FRICS FC1 Arb,	Leeds Permanent Building Society
Vernons, Chartered Surveyors	Local Authority Valuers Association
Association of County Councils	Lord Chancellor's Department
Mr G T Barker	Lloyds Bank
J Bennet BSc, FRICS, West of England	W Metcalf FRICS
Building Society	National Association of Estate Agents
A G Bradley, FRICS, ABBS1	Nationwide Anglia Building Society
Joseph R Bradshaw	National Consumer Council
Britannia Building Society	The National Farmers Union
British Air Survey Association	National Westminster Home Loans Limited
British Telecom	Mr T and Mrs G Oldbury
The Building Society Association	Charles A Pritchard, ARICS ARVA,
CBI	Swetenhams, Royal Life Estates
The Chartered Institute of Arbitrators	Property Consultants Society
D Clarke, Halifax Building Society	Property Services Agency
M F Clarke, FNAEA, M F Clarke & Co	T J V Rains FRICS, Prudential Property
Consumers' Association	Services
County Landowners Association	Rating Surveyors Association
A D Cummings, Taylor, Lane, & Crebar	Rating and Valuation Association
Donald J Balmer, Donald Balmer & Co	The Royal Institution of Chartered Surveyors
Department of the Environment	The Royal Town Planning Institute
Department of Trade and Industry	C Smalls, G A Property Services
Department of Transport	D Spencer, Leeds Permanent Building Society
Nicholas J S Ellis	Society of Fine Art Auctioneers
J Evans, FRICS, Beresford Adams	T B Stapleton, M Phil, BSc, FRICS,
T D Evans, FRICS, Dixon Webb	Department of Surveying, Bristol
FCO	Polytechnic
Michael Ford, Bond Pearce	The Survey Association (UK Land and
Mrs M Gleeson	Hydrographic Survey Association)
Ian Hadfield, Boulton Hadfield & Co	Surveyors Mutual Insurance Association
The Halifax Building Society	Limited
Robert Heckford	Christopher Weston, Phillips Fine Art
T Higgins, Leeds City Council	Auctioneers & Valuers
D Hogg, Halifax Estate Agent	The Woolwich Building Society
The Hydrographic Society	Yacht Brokers, Designers and Surveyors
Incorporated Society of Valuers and	Association
Auctioneers	

Consumers' Association

Publishers of **Which?**

2 Marylebone Road
London NW1 4DX
Telephone 01-486 5544
Telex 918197
Fax 01-935 1606

Miss L Birch
Professional Liability Review
Valuation and Other Surveyors Study Team
DOE Secretariat
Department of the Environment
2 Marsham Street
London SW1

Ref: DP/EH/TC

28th October 1988


Dear Miss Birch

PROFESSIONAL LIABILITY

GOVERNMENT FACT FINDING STUDY: VALUATION AND OTHER SURVEYORS

Thank you for your letter of 24th August which the Chairman has asked me to reply to. We are pleased to be given the opportunity to submit our views to the study into professional liability issues in the context of valuation and other surveying services.

We note that the study has been set up as a result of the concern of a range of professions at the increasing number of people using the courts to claim damages for professional negligence, at the dramatic increase in the amounts involved, and the concern about the cost and availability of professional indemnity insurance. We understand from the terms of reference that the aim is to establish the facts about the effect on valuation and other surveyors (among others) of the way the law operates in providing remedies to those who suffer loss as a result of the way in which a professional person performs his duties.

We have left the issue of the effect on surveyors to the professionals themselves. Our concern is with consumers. We have some general observations to make on the issue of professional liability as it affects them.

We are of course familiar with the anxieties of several professional bodies with the growth of negligence claims. We are not unsympathetic to the difficulties some professionals experience in obtaining adequate cover by way of insurance against professional negligence liability. But the solution is not to limit this liability. On the contrary, negligence is a serious matter, which should give right to full compensation. It is in any event far from easy to prove, and we are still concerned at the difficulties experienced in pursuing claims. It is not always easy to procure the necessary evidence from other professionals about the standards of professional care and skill which a particular situation demanded. There is still a significant distinction between errors of judgement (which give rise to no right to compensation) and

negligence as such (which does). In other words, only in relatively clear cases does a finding of negligence arise, and if a case is marginal, it is resolved in favour of the professional.

We accept, of course, in the end at least some of the additional cost of liability arising from these increased claims may fall on the consumer. This applies both to insurance premiums and to personal liabilities where the risks are not insured. But any increased prices are paid by consumers generally; while limits to professional liability would in effect be paid for by the consumer who has suffered negligence of a kind which is no longer covered. In our view it is right that all consumers of services should contribute towards appropriate recompense for the minority of consumers who suffer from deficiencies of service and seek redress for those deficiencies.

We do however recognise the case for clarifying certain aspects of liability so that consumers and professionals know exactly where they stand. As far as surveyors are concerned, we have a particular interest in their role in the house transfer system. The liability of a surveyor, carrying out a valuation on behalf of a lender for example, but which is paid for by the prospective house-buyer, is not at all clear. In cases which have come before Courts, (Yianni etc) the consumer has been treated reasonably favourably. The uncertainty remains however. We would welcome a rationalisation of the relationship and responsibility of the surveyor to house-buyers.

There is also the question of vendors surveys. If the practice of a house-owner obtaining a survey on a property prior to putting it on the market is ever to become the norm, (a move which we consider would do a lot to improve the house transfer system), then the question of the liability of the surveyor to the house purchaser would have to be clarified.

Even when the liability of a surveyor to a consumer has been established and a surveyor has been found to have been negligent the entitlement of the consumer to compensation for negligence is based on the difference between the value of the property with the defect, which the surveyor failed to point out, and the value of the property without such a defect, at the time the survey took place. In general, defects have to be substantial to be actionable and, it follows, have a substantial effect on the value of the property; in most cases taking the claim outside the current £500 limit of the small claim jurisdiction. We think entitlement to compensation should be based on the cost of putting the defect right. We would welcome clarification of this issue in law.

We are enclosing a copy of the most recent Which? report on house transfer, published in April 1987, which highlights very clearly the main problem areas encountered by our members, and where we consider action is needed. We are currently carrying out a survey of Which? members who have moved within the last year for a report on surveyors due to be published in February 1989, and will send you a copy in due course.

Yours sincerely



Derek Prentice

Head of Campaign and Representation

Clients Questionnaire

1. To assist the Study Team a random sample of consumers were invited to complete a Clients Questionnaire (copy attached). This was designed to identify the spread of work for which negligence claims were arising, consumer understanding and attitudes towards the services on offer and the quality of the services obtained.

2. A total of 942 copies of the Questionnaire were sent out to individuals and companies.

364 replies were received—a response of 38.6 per cent.

3.	<i>Questionnaires Sent Out</i>	<i>Replies Received</i>	<i>%</i>
Private Individuals	463	215	46.4
Private Sector			
Company/Partnership	185	76	41.1
Public Utility	14	2	14.3
Local Authority	200	63	31.5
Government Department	14	1	7.1
Other (letters sent to eg banks, building societies etc)	66	7	10.7

4. Of those who responded 133 (36.5 per cent) had not used any of the services listed. Of the remaining 231: 170 had used Estate Agency services; 105 Property Valuation; 94 Full Structural Survey or House/Flat Buyers report, and 92 Mortgage Valuation. These are the four main services used by those replying.

5. Only 26 of those who had used some of the services said they were dissatisfied with the nature of the services provided. Of those only four had brought a claim within the last five years—none with legal aid. One of those was dissatisfied with the way the claim was handled, but the only reason given was ‘because he lost’.

6. Although the number of replies to a survey of this kind was quite high it is difficult to draw any firm conclusions since it does not appear to have reached many of those who may have had any real problems.

7. On the basis of the sample taken it would appear from the clients’ point of view that there is little evidence of a problem in relation to negligence overall, but it is clear from letters from individuals that when things do go wrong substantial negligence problems can arise for the consumer.

PROFESSIONAL LIABILITY STUDY

CLIENTS QUESTIONNAIRE

The Government has commissioned a series of fact-finding studies into the professional liability of selected professions. To assist the Study into valuation and other surveying services—including public understanding and expectations of the services on offer, a sample of users is being invited to complete this Questionnaire, and some organisations are mailing a selection direct. Your answers and the fact that you have given them will remain *confidential* to the Department and will not be used for any other purpose. Please complete—*tick the appropriate boxes* and return by 16 September to: Miss L P H Birch, Department of the Environment, C14/19A, 2 Marsham Street, London SW1P 3EB. (Please return this form even if answer to Q3 is ‘none’.)

1. Name, address and telephone number

Your reference

2. In what capacity are you completing this questionnaire?

☐	Private Individual
☐	Private Sector Company/Partnership
☐	Public Utility
☐	Local Authority
☐	Government Department
☐	Other (please specify)

3. Which of these surveying services have you used in the last 5 years?

☐	Estate Agency	☐	Project Management
☐	Mortgage Valuation and Survey	☐	Mortgage Advice
☐	Full Structural Survey or House/flat buyers Report/Survey	☐	Planning Consultancy
☐	Property Valuation including Rating	☐	Auctioneering
☐	Landlord and Tenant	☐	Land Agency
☐	Management—urban	☐	Agricultural Estate Management
☐	Financial and Funding Advice	☐	Other (Specify)
☐	Development Consultancy	☐	None

4. Did you specifically engage a *qualified* surveyor?

Yes	☐	No	☐
-----	--------------------------	----	--------------------------

5. Were the terms of engagement confirmed in writing by you or the surveyor?

Yes	☐	No	☐
-----	--------------------------	----	--------------------------

6. Were you able to obtain the surveying services you required?

Yes

No

7. If a building society's or other lender's valuation report was available to you, did you:
—rely on it solely:

Yes

No

—did you also commission your own survey/report:

Yes

No

8. Were you satisfied with the services provided?

Yes

No

If not, why not

.....

9. If your dissatisfaction was because of alleged negligence did you bring a claim—within the last five years?

Yes

No

If not, why not

10. With which of the services listed in Q3 was your claim concerned:

.....

11. Did you bring a claim with legal aid?

Yes

No

12. In the last 5 years have you:

—had a claim settled	Yes		No	
—lost a claim	Yes		No	
—been involved in a court case	Yes		No	
—agreed a settlement out of court	Yes		No	

13. Were you satisfied with the way the claim was handled:

Yes

No

If not, why not

.....

14. Would you be prepared to take part in a follow-up questionnaire/short interview?

Yes

No

15. Any other comments

Professionals Questionnaire

Initial Survey

1. To assist the Study Team a random sample of professionals were invited to complete a Professionals Questionnaire. This was designed to elicit experience, if any, of PI problems and risks, and negligence claims.

2. A total of 441 copies of the Questionnaire (copy attached) were sent to surveyors: RICS members (100) and ISVA members (239), and to estate agents: NAEA members (102).

By the date requested 112 replies had been received and of these 85 were prepared to take part in a follow-up.

3. An analysis of those replying and agreeing to take part in a follow-up showed that they were fairly representative of practitioners across the country and followed a similar pattern in terms of the spread of size of operation. Similarly, more small firms than large ones were prepared to take part in a further follow-up survey.

4. The main point to show up from this Questionnaire was that a fairly large proportion of the small firms had indicated that they had stopped offering structural surveys. Over half of the small firms had changed their working methods. The majority of those who agreed to take part in the follow-up survey said that they were greatly concerned about the increasing risks associated with professional liability.

PROFESSIONAL LIABILITY STUDY

PROFESSIONALS QUESTIONNAIRE

The Government has commissioned a series of fact-finding studies into the professional liability problems of selected professions. You are invited to complete the Questionnaire, sent to a random sample, to assist the Study Team concerned with valuation surveyors.

Your answers and the fact that you have given them will remain *confidential* to the Department and will not be used for any other purpose. Please complete—*tick the appropriate boxes*, and return by *20th June* to: Miss L P H Birch, Department of the Environment, C14/19A, 2 Marsham Street, London SW1P 3EB.

1. Name, address, and telephone number of Firm
.....

Your Reference

2. What is the total complement (including principals)?

0 to 10	☐	50 to 100	☐
11 to 24	☐	more than 100	☐
25 to 49	☐		

3. Which of these activities do ► you undertake?	☐	Estate Agency	☐	4. In the last 5 years have you stopped offering any of these services? ◀
	☐	Mortgage Valuation and Survey	☐	
	☐	Structural Survey	☐	
	☐	Property Valuation including rating	☐	
	☐	Landlord and Tenant	☐	
	☐	Management	☐	
	☐	Financial and Funding Advice	☐	
	☐	Development Consultancy	☐	
	☐	Project Management	☐	
	☐	Mortgage Advice	☐	
	☐	Planning Consultancy	☐	
	☐	Auctioneering	☐	
	☐	Land Agency	☐	
	☐	Agricultural Estate Management	☐	
	☐	Other	☐	

5. Why have you stopped offering any services in Q4 above?

6. Have indemnity considerations caused you to change your working methods?

Yes

No

- Have these changes involved:
- altering the normal terms of engagement eg use of disclaimers
 - written confirmation of instructions in all instances
 - restricting the content and advice in reports for clients
 - introduction of risk management procedures
 - specialist staff training
 - other

7. Has your practice had experience of indemnity insurance claims in the last 5 years?

Yes

No

Have you recently:

—settled claims yourself	Yes		No	
—paid out within your excess	Yes		No	
—been involved in a court case	Yes		No	
—agreed a settlement through insurers	Yes		No	

8. To what extent do indemnity insurance considerations currently concern your firm

—Not at all		Somewhat		Greatly		
—Have you increased your cover limit?	Yes		When		No	
—Have you changed your broker?	Yes		When		No	
—Have you had difficulty in obtaining adequate cover?	Yes		When		No	

9. Would you be prepared to take part in a follow-up questionnaire/short interview?

Yes

No

10. Any other comments

.....

PROFESSIONALS FOLLOW-UP SURVEY

1. 92 copies of the Questionnaire (copy attached) were sent out. 53 (57.6 per cent) replies were received (2 firms were no longer able to take part because of changed circumstances).
2. The overall response was disappointing, with perhaps some of those responding being put off by the length of the Questionnaire. There were also some obvious discrepancies in how the form had been filled in. Nevertheless there was a common thread running through the replies, which was of relevance to the Study Review.
3. Although statistically limited the response showed that among the smaller firms up to 30 per cent of residential and 25 per cent of commercial firms had stopped offering some services. This was not unexpected since in risk and PI terms, the most vulnerable, and those with limited resources are the smaller firms.
4. Of those qualified professionals who were actually carrying out surveying work, age had not emerged as a factor. In small practices the same person was probably doing the work and handling the claims.
5. Some 55 per cent said that they had changed their working methods specifically because of PI considerations. Within the limitations of this Survey it could be said that this was a significant number. It could also be concluded from the responses that a general improvement in the control of records had taken place in the last few years because of PI considerations.
6. While there seemed to be a reluctance to admit that risk management as such had been introduced, it was evident that some changes had taken place eg the introduction of staff manuals, staff meetings etc.
7. The responses to this questionnaire suggested that realistic targets for the number of surveys (residential) to be carried out per day had been set. However the Review Team did not think this represented the whole picture as anecdotal evidence had indicated much higher targetting by bodies under great commercial pressure.
8. Of particular interest were the answers to Question 25(ii), which was directly related to PI showing that nearly one third (13 out of 45) of the smaller firms had changed their policy in carrying out surveys. Question 26 showed that nearly two thirds (28 out of 45) said that they had changed their working methods on the residential side.

PROFESSIONAL LIABILITY STUDY

PROFESSIONALS FOLLOW-UP

You have kindly agreed to take part in this follow-up questionnaire. Your answers and the fact that you have given them will remain *confidential* to the Department and will not be used for any other purpose. *Please complete sections A. Commercial and/or B. Residential by ticking boxes etc.* and return by 15 November to: Miss L P H Birch, Department of the Environment, C14/19A, 2 Marsham Street, London SW1 3EP.

1. Name, address and telephone number of Firm
.....

Your Reference

2. What is the total number of qualified staff?

SECTION A. COMMERCIAL

3. Which of these activities are you <i>willing</i> to undertake?		Estate Agency		4. Which of these activities do you undertake on a <i>regular</i> basis?
		Mortgage Valuation and Survey		
		Structural Survey		
		Property Valuation		
		Valuation for Rating Purposes		
		Landlord and Tenant		
		Management		
		Financial and Funding Advice		
		Development Consultancy		
		Mortgage Advice		
		Planning Consultancy		
		Auctioneering		
		Land Agency		
		Agricultural Estate Management		
		Other		

Any Other Comments

5. Did you stop offering any of these services listed in Questions 3 and 4 between 1978 and 1988?
Yes ☐ No ☐ Please specify which services in which year.

Year 1978/79	1979/80
1980/81	1981/82
1982/83	1983/84
1984/85	1985/86
1986/87	1987/88

6. If you have stopped offering any of these services in the last 10 years, is this because of deliberate internal policy ☐; or because of outside forces ☐ or both ☐.

Please clarify

Any Other Comments

7. If you provide 'financial and funding advice' is this service limited to introductory fee work ☐ tied agency work ☐.

if other advice is offered please specify

8. (i) For how many years has the firm been established?

(ii) Is there a minimum length of service for those permitted to carry out surveys?
Yes ☐ No ☐

—If yes, please specify

(iii) Give numberr of staff in each band:

under 25 years	25–35 years	36–45 years
46–55 years	56–65 years	Over 65 years

(iv) Give numbers of staff according to experience of professional work.

less than 5 years' experience
more than 5 years' but less than 10 years' experience
more than 10 years' experience

(v) Have you changed your recruitment policy in the last 5 years?
Yes ☐ No ☐

If yes, when?	and in what way?
.....	

(vi) What is your policy with regard to consultants?

.....

Any Other Comments

9. Have you changed your working methods in last 5 years ☐ between 1978-83 ☐
Not at all ☐

Is this change specifically because of indemnity considerations ☐ , other ☐

please specify

10. Have you introduced in the last ten years

- specialist staff training manuals Yes ☐ When ☐ No ☐
- greater attendance at outside conferences etc. Yes ☐ When ☐ No ☐
- greater supervision of newly qualified/inexperienced staff? Yes ☐ When ☐ No ☐
- use of preparation of explanatory material to inform public? Yes ☐ When ☐ No ☐
- a standard procedure to give public explanatory material? Yes ☐ When ☐ No ☐
- a standard procedure of enclosing explanatory material for client with written confirmation of instructions? Yes ☐ When ☐ No ☐
- risk management ☐; if so please explain exactly what this has involved and when introduced

.....
.....

Any Other Comments

11. (i) Has your practice had experience of indemnity insurance claims in the last 10 years?
Yes ☐ No ☐

(ii) What is the number of claims in each year?

1978/79	1979/80	1980/81
1981/82	1982/83	1983/84
1984/85	1985/86	1986/87
1987/88		

The total number of claims in the last 10 years

(iii) In your experience what is the most common way of disposing of claims?
.....

(iv) Does the size of the claim affect the way in which the claim is disposed of? Yes ☐ No ☐

12. Any Comments
- (v) How many claims resulted in a payment?
- (vi) How many claims notified to/handled by insurers?
- (vii) What were the claims for? Please specify using the activities listed in Question 4
-
- (viii) Any Other Comments?
13. Has your *cover* limit been increased recently? Yes ☐ No ☐
- Why?
- Comment
14. Have you re-assessed your insurance indemnity requirements
- in the last 5 years? Yes ☐ No ☐
- in the last 10 years? Yes ☐ No ☐
- continuous review? Yes ☐ No ☐
15. (i) Do you foresee problems in obtaining qualified staff
- now? Yes ☐ No ☐
- in future? Yes ☐ No ☐
- (ii) How does your recruitment policy reflect such concern?
-
16. In your opinion:
- (i) is the client better informed today about what he/she wants?
Yes ☐ No ☐
- (ii) does the client understand more clearly what service is being provided?
Yes ☐ No ☐
- Any Further Comments
17. Additional views?

SECTION B. RESIDENTIAL

18. Which of these activities are you willing to undertake?		Estate Agency		19. Which of these activities do you undertake on a regular basis?
		Mortgage Valuation		
		House/flat buyers Report/Survey		
		Structural Survey		
		Property Valuation		
		Valuation for Rating Purposes		
		Landlord and Tenant		
		Management—urban		
		Financial and Funding Advice		
		Development Consultancy		
		Mortgage Advice		
		Planning Consultancy		
		Auctioneering		

Any Other Comments

20. What percentage of the firm's work is concerned with providing the following services:

—mortgage valuation%

—house/flat buyers reports/surveys%

—structural surveys%

21. Did you stop offering any of these services listed in Questions 18 and 19 between 1978 and 1983? Yes ☐ No ☐ Please specify which services in which year

Year 1978/79	1979/80
1980/81	1981/82
1982/83	1983/84
1984/85	1985/86
1986/87	1987/88

22. If you stopped offering any of these services in the last 10 years, is this because of deliberate internal policy ☐; or because of outside forces ☐ or both ☐.

Please clarify

.....

Any Other Comments

23. If you provide 'financial and funding advice' is this service limited to introductory fee work ☐
 tied agency work ☐ ; if other advice is offered please specify

24. (i) For how many years has the firm been established?
- (ii) Is there a minimum length of service for those permitted to carry out surveys?
 Yes ☐ No ☐

—If yes, please specify

- (iii) Give number of staff in each band:
- under 25 years 25–35 years 36–45 years
 46–55 years 56–65 years Over 65 years

- (iv) Give numbers of staff according to experience of professional work
- less than 5 years' experience
 more than 5 years' but less than 10 years' experience
 more than 10 years' experience

- (v) Have you changed your recruitment policy in the last 5 years?
 Yes ☐ No ☐

If yes, when? and in what way?.....

- (vi) What is your policy with regard to consultants?

Any Other Comments

25. (i) What is the target quota per person per day for the following?
- mortgage valuations
 —housebuyers survey
 —structural survey

- (ii) Are the target quotas linked to the percentages in Question 20?

- (iii) How many surveys do you expect qualified staff to achieve for the three categories in a year?
- mortgage valuations
 —housebuyers survey
 —structural survey

(iv) Have the targets been increased over the last five years?

Yes ☐ No ☐ If so, when and by
how much

(v) Has your policy on carrying out valuations and surveys changed in the last five years? ...

26. Have you changed your working methods in the last 5 years ☐ between 1978-83 ☐
Not at all ☐

Is this change specifically because of indemnity considerations ☐ , other ☐ please specify
.....

27. Have you introduced in the last ten years

—specialist staff training manuals? Yes ☐ When ☐ No ☐

—greater attendance at outside conferences etc.? Yes ☐ When ☐ No ☐

—greater supervision of newly qualified/inexperienced staff? Yes ☐ When ☐ No ☐

—use of preparation of explanatory material to inform public? Yes ☐ When ☐ No ☐

—a standard procedure to give public explanatory material? Yes ☐ When ☐ No ☐

—a standard procedure of enclosing explanatory material for client with written confirmation of
instructions? Yes ☐ When ☐ No ☐

—risk management ☐ ; if so please explain exactly what this has involved and when introduced
.....
.....

Any Other Comments

28. (i) Has your practice had experience of indemnity insurance claims in the last 10 years?
Yes ☐ No ☐

(ii) What is the number of claims in each year?

1978/79 1979/80 1980/81

1981/82 1982/83 1983/84

1984/85 1985/86 1986/87

1987/88

The total number of claims in the last 10 years

(iii) In your experience what is the most common way of disposing of claims?
.....

(iv) Does the size of the claim affect the way in which the claim is disposed of? Yes ☐ No ☐

Any Comments

(v) How many claims resulted in a payment?

(vi) How many claims notified to/handled by insurers?

(vii) What were the claims for? Please specify using the activities listed in Question 19

.....

(viii) Any Other Comments?

29. Has your *cover* limit been increased recently? Yes ☐ No ☐

Why?

Comment

30. Have you re-assessed your insurance indemnity requirements

—in the last 5 years? Yes ☐ No ☐

—in the last 10 years? Yes ☐ No ☐

—continuous review? Yes ☐ No ☐

31. (i) Do you foresee problems in obtaining qualified staff

—now? Yes ☐ No ☐

—in future? Yes ☐ No ☐

(ii) How does your recruitment policy reflect such concern?

.....

32. In your opinion:

(i) is the client better informed today about what he/she wants?

Yes ☐ No ☐

(ii) does the client understand more clearly what service is being provided?

Yes ☐ No ☐

Any Other Comments

33. (i) In general do you consider that the public are less well served ☐ or receive the same service as before ☐ or are better served now ☐ by the property world including building societies and banks.

(ii) Over what period do you consider these changes (if any) to have taken place. In the last 10 years ☐ : or five years ☐ or three years ☐ or one year ☐.

34. Additional Views?

.....

References in the Text of Section 5 of the Report

- (1) see section 13 and 14
- (2) Liability for death or personal injury cannot be excluded at all
- (3) the guidelines include (a) the relative bargaining strengths of the parties (b) whether the consumer received an inducement to agree to the term and whether he could have obtained the same thing elsewhere without having had to have agreed to the term (c) whether the terms conform to any trade custom.
- (4) eg *Kenney v Hall Pain and Foster* (1976) 239 EG 355
- (5) *Wimpey Construction (UK) Ltd v Poole* [1984] 2 Lloyd's Rep 499. But see *Duchess of Argyll v Beuselinck* [1972] 2 Lloyd's Rep 172. The position is far from clear.
- (6) *Yianni v Edwin Evans & Sons* [1982] QB 436; *Singer and Friedlander v John D Wood & Co* (1977) 243 EG 212
- (7) *Shankie-Williams v Heavey* (1986) 279 EG 316
- (8) Jackson and Powell on Professional Negligence (2nd edn) p 128
- (9) *Smith v Eric S Bush* [1987] 3 All ER 179; *Harris v Wyre Forest DC* [1988] 1 All ER 691
- (10) *London and South of England Building Society v Stone* [1983] 1 WLR 1242
- (11) *Treml v Gibson (Ernest W) and Partners* (1984) 272 EG 68
- (12) *Roberts and Another v J Hampson & Co* [1988] 2 EGLR 181
- (13) *McIntyre v Herring Son & Daw* [1988] 1 EGLR 231

ANNEX IX



International Bar Association

A Federation of National Legal Associations
and Individual Lawyers

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Ms Lillian P H Birch
Department of the Environment
Room C14/19A
2 Marsham Street
London
SW1P 3EB

16 January 1989

19/1
~~Dear Ms Birch~~

I have pleasure in enclosing* a report adopted by the International Bar Association at its 1988 General Meeting together with the following resolution:

- (i) that all Governments worldwide be urged to introduce legislation limiting professional indemnity claims; and
- (ii) relevant professional organisations worldwide be encouraged to support the introduction of such legislation.

The IBA hopes that you may be able to lend your support to the proposals in this report and I should, of course, be happy to answer any questions that you may have.

The IBA is a strictly non-political organisation with some 12,000 individual lawyer members worldwide and 111 member Bar Associations and Law Societies, including the six professional legal bodies in the United Kingdom. It is recognised as the world's leading - and largest - international organisation of lawyers.

Yours sincerely

Madeleine May
Madeleine May
Executive Director

Enc

MM/jwd



International Bar Association

Professional Indemnity Insurance: Proposals for Legislation

Adopted by the General Meeting
September 1988

In recent years the cost and availability of professional indemnity insurance have been causing increasing problems in the western world generally and in particular in the United States of America. The United States Government established a Tort Policy Working Group consisting of officials of Federal Agencies presided over by an Assistant Attorney General (Richard K Willard). In 1986 the Working Group issued a Report entitled 'Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Current Crisis in Insurance Availability and Affordability', and in March 1987 issued a further Report entitled 'An Update on the Liability Crisis'. The nature of the anxiety felt by the United States Government is accurately reflected in the title of these Reports. A single statistic will be sufficient to indicate the gravity of the situation: in 1985 premiums for doctors practising in obstetrics/gynaecology averaged \$51,420, being 51.6 per cent of net income. Obviously premiums of this nature have had a dramatic effect. A survey conducted by the American Consulting Engineers Council revealed that 19 per cent of consulting engineers were practising without insurance cover. A survey conducted by the State Bar of California concluded that nearly half the State's lawyers in private practice carry no insurance and a member of the American Bar Association's Standing Committee on Lawyers' Professional Liability has said that in the United States as a whole the figure is 20-45 per cent. Problems of availability and affordability have been contained to some extent as a result

of higher deductibles, lower coverage limits and additional Policy exclusions and limitations. There has also been increasing reliance on self insurance and captive insurance programmes although it is too soon to say whether these will result in greater availability of cover or less cost. As the Working Party put it:

'Despite some assertions to the contrary, the impact of the crisis in insurance availability and affordability continues to be felt—often acutely—throughout much of the American economy'.

Although the problem has not become as acute in other developed countries it is serious and, in our view, will become increasingly so. It is now impossible to obtain adequate cover for the largest risks and, in addition to lawyers, it is an acute problem for architects, consulting engineers and accountants. There are claims pending or threatened which, if successful, would result in bankruptcy of all the partners in some of the largest firms of solicitors and accountants in the world.

The gravity of the situation in the United States of America led to the Working Group making a number of far-reaching recommendations:

1-16 States implemented in various ways and to a differing extent a recommendation that the doctrine of joint and several liability be eliminated. This doctrine which exists in most, if not all, Common Law countries, provides that if two Defendants are to blame

for the Plaintiff's loss, if one Defendant cannot pay for his share of the liability, it must be paid by the other Defendant.

2—The Working Group recommended that damages for non-economic loss should not exceed \$200,000. 8 States have enacted legislation to cap non-economic damages in sums ranging from \$250,000 (Colorado) to \$875,000 (New Hampshire) while 5 States have enacted limitations for medical malpractice cases in sums ranging from \$225,000 (Michigan) to \$1,000,000 (Wisconsin and West Virginia). These pieces of legislation reflect the fact that the Working Group reported that medical malpractice insurance is extremely difficult to obtain, that 'the major Commercial Insurers are writing only renewals, and are not writing new Policies'. The effect of such limitations is dramatic given that the average medical malpractice jury award was said to be \$2,056,525 in 1986.

3—The Working Group recommended that the collateral source rule, prohibiting the consideration of the offset of collateral benefits, be modified or eliminated and this has been done in 11 States. By 'collateral sources' is meant any payment of benefit paid by Central, State or Local Government together with payments under a workers' compensation system or health insurance programme funded by an employer.

That the situation is considered as grave in other countries, can be demonstrated by the following examples:

Netherlands

In the Netherlands the Nederlandse Juristen-vereniging (Dutch Association of Jurists), an association with a membership of several thousand members (practitioners, general counsels, judges, law professors), discussed at its summer meeting in June 1987 the necessity of legal measures to limit the liability of professionals.

In two 'prae-adviezen' Mr F H A Arisz, an Amsterdam lawyer and Mr J G C Kamphuisen, Managing Director of a large insurance broker, both pleaded to have such legal measures taken.

The vote of the meeting, taken after the debate, was clearly in favour of such measures.

Introduction in the Netherlands could be relatively easily made, as a project for a new Dutch Civil Code will come before parliament early in 1990, and the limitation by both rapporteurs was construed as an extension of Book VI of

that Code in a new article (6.1.9.12^b NBW). The system would be that the government without intervention of parliament could set limits—varying in different circumstances for different professions—under which the professional should take obligatory insurance cover, but that cover taken, he would be freed for the rest. It may furthermore be remarked, that both rapporteurs point out with regard to the Dutch scene in their respective reports (without giving further details):

- difficulty in finding adequate cover;
- an increase in the number of claims against lawyers, but especially an increase in the amounts claimed.

United Kingdom

The situation is not as acute as in the United States but it is bad and is getting worse. Problems of affordability and availability are on the increase. Much of the world-wide professional indemnity insurance is written in Lloyds and the London market is very conscious of its American experiences. In his report on the year 1986, the Chairman of Lloyds commented that 'quite extraordinary court awards and judicial interpretations continue to come from, in particular, the American scene'. As a result, the number of those prepared to write these risks has diminished and those who do so have become increasingly selective and write the risks on draconian terms as to deductibles, coverage, limitations and exclusions. Solicitors have established their own mutual scheme, barristers are in the process of doing so and doctors have done so for many years. However, the most that such schemes can hope to achieve is to cut out insurers' profit element and ensure that the profession is not held to ransom as to premiums because of the dearth of insurers prepared to write the risks.

Representations to Government have been made by the professions on a number of occasions in the last few years. In October 1987 the Government announced that fact-finding studies were to be commissioned to consider professional liability problems for selected professions, namely accountants and those in the construction industry. The last term of reference is to be: 'if appropriate, suggest possible next steps for future consideration of the subject.'

The committee has not had sufficient time to research the experience in other countries but their view is that even if the situation is not acute or may not even have arisen in some countries it is likely to do so in the future.

Conclusions

Of course, any legislature which is considering any limitation on damages will have regard to the interests of the consumer, which in this case means the person who is claiming damages. However, by 'consumer' what is meant is an individual in his private capacity. The man in the street or his family needs to be able to recover damages for death, injury and the value of his home and contents. Outside the United States, professional people are able to obtain cover at reasonable rates in respect of those risks. The risk of bankruptcy arises when a professional person is sued by a Limited Company or Central or Local Government. The concept of Limited Companies was introduced because it was thought right to limit the liability of participants in such Companies. It is ironical that professional people should be at risk of bankruptcy at the hands of shareholders in Limited Companies who themselves have the advantage of personal immunity from suit if the Company cannot meet a judgment against it. It is suggested that this is an obvious anomaly.

In the Committee's view legislation limiting damages is the obvious solution, subject to safeguards for the man in the street. In countries outside the United States of America, where damages in cases of personal injury or death are at levels for which insurance is both available and affordable, the proposed legislation would provide for compulsory insurance up to a figure which would be, sufficient to ensure that the man in the street recovers damages in full. It would be impermissible to limit or exclude liability beneath this sum. Above that sum there would be no liability in the absence of a contractual term to that effect. Of course, in the United States and in any other country where damages for personal injury or death have reached the sums they have in the United States, it may be necessary to put a limitation on damages which is less than a plaintiff would be expected to receive at present.

Attempts have been made in various countries to obtain legislation to cap damages but these have tended to have been made by individual professions rather than by the professions acting in concert. In our view it is plain that any capping of damages should not apply only to selected professions, as has been done in some of the States in America in respect of doctors, but must apply to all professions. Indeed we consider it most unlikely that any legislation of the kind proposed would be acceptable unless it extended to people who are not members of a

profession. For example, there seems no reason why an architect should have the benefit of any limitation of damages but that a self-employed builder should not and the injustice would be manifest if both are sued in the same action. In our view the protection of any such legislation should be extended to anyone who wishes it, provided he obtains the necessary insurance and agrees to the provisions relating to exclusion and limitation of liability. We consider that legislation along these lines would be just.